1 FEDERAL TRADE COMMISSION

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4 COMPETITION AND CONSUMER PROTECTION

5 IN THE 21ST CENTURY

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12 Thursday, December 6, 2018

13 8:45 a.m.

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17 New York University School of Law

18 40 Washington Square South

19 New York, New York

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1 FEDERAL TRADE COMMISSION

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1 **WELCOME**

2 MR. HEMPHILL: Hi, everyone. Why don't we
3 get started. Welcome to the New York University
4 School of Law. My name is Scott Hemphill and I'm a
5 professor here at the law school. NYU, joined by our
6 Engelberg Center on Innovation Law, is delighted to be
7 hosting this eighth session in the hearings
8 initiative.
9 Today's hearing focuses on the question of
10 common ownership by investors in competing firms and
11 related issues at the intersection of antitrust and
12 corporate governance. My first order of business
13 today is to invite our dean, Trevor Morrison to offer
14 a welcome. Trevor?
15 (Applause.)
16 MR. MORRISON: Thank you, Scott, and good
17 morning. Let me be the second to welcome you all here
18 to NYU Law. We really are thrilled to be hosting this
19 hearing of the FTC. Thanks to the FTC for joining us
20 in this. We certainly think that if the hearing is
21 going to be held in New York, it's absolutely fitting
22 that it be here at NYU Law.
23 We have a great many people in our
24 community, on our faculty engaged in the issues that
25 the FTC is engaged in, and many of them will be

1 speaking today, including Scott Hemphill, Dan
2 Rubinfeld, and Ed Rock, and of course our colleague,
3 Marcel Kahan works closely on these issues and with
4 Scott as well. So with that cohort of faculty working
5 on these issues, we're certainly glad to be able to
6 bring and host the FTC here today. And I wish you
7 very well for this hearing. Again, welcome and thank
8 you.
9 MR. HEMPHILL: Thanks, Trevor. So next, I
10 have a couple of housekeeping items. FTC staff has
11 asked me to remind everyone that this is a public
12 event and is being webcast, photographed, and
13 recorded. By participating in this event, you're
14 agreeing that your image and anything you say or
15 submit may be posted indefinitely at FTC.gov --
16 (Laughter.)
17 MR. HEMPHILL: -- or on one of the
18 Commission's publicly available social media sites. A
19 transcript of today's proceedings will be posted as
20 well. Question cards will be available throughout the
21 day. Please use them to write down questions for
22 panelists. Staff will collect them and pass them to
23 the moderators who may pose selected questions if time
24 permits. Finally, if you have your mobile phone with
25 you, please silence it.

1 So let me also echo Trevor's welcome. It's
2 particularly fitting that the session is held at NYU
3 Law for two reasons. The first Trevor already gave,
4 this school's deep engagement with some of these
5 questions and more generally the role that financial
6 services play as the lifeblood of New York City.
7 The second reason that I just wanted to
8 emphasize for a minute comes back to the late Bob
9 Pitofsky, Former Chair of the Federal Trade Commission
10 and a dear friend to many of us. Today's hearing, and
11 the FTC's series of hearings more generally, were
12 inspired by Bob's desire to keep the FTC abreast of
13 cutting-edge issues in antitrust and consumer
14 protection. Chairman Pitofsky held a series of public
15 hearings in order to advance that aim, and this is
16 very much in that tradition.
17 Now, as some of you know, Bob Pitofsky and
18 NYU have a deep connection. Before Bob was a public
19 servant, he was a professor of law here at NYU. Bob
20 joined our faculty in 1964 at the urging of our late
21 colleague, the great Norman Dorsen. Such was their
22 friendship that Bob led the school's Hays Program on
23 civil liberties while Norman was on sabbatical. And
24 the favor was returned. Norman Dorsen filled in one
25 year to teach Bob's antitrust class. So all of us at

1 NYU are particularly pleased to reconnect in this way
2 with Bob's legacy as a scholar and as a public
3 servant.
4 So as you guys have seen, we have a full
5 agenda today. Our first session features two sitting
6 Commissioners, one from the Federal Trade Commission
7 and one from the Securities and Exchange Commission,
8 who will be giving some remarks. So first up is Noah
9 Phillips. Commissioner Phillips was confirmed by the
10 Senate in April. Prior to the Commission, he served
11 as Chief Counsel to Senator John Cornyn on the Senate
12 Judiciary Committee and a variety of other roles
13 advising the Senator.
14 Prior to his Senate service, Commissioner
15 Phillips worked at Wasserstein Perella, an investment
16 bank, and as a litigator at Cravath Swain & Moore.
17 So Commissioner Phillips, the floor is
18 yours.
19 (Applause.)
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1 **OPENING REMARKS AND DISCUSSION**

2 COMMISSIONER PHILLIPS: Thank you for the
3 kind introduction and also the privacy warning. This
4 is not our privacy hearing, but it's important that
5 everyone think about that all the time.
6 I'm really, really thrilled to be here to
7 open today's excellent hearing and to welcome the
8 distinguished group of scholars and market
9 participants from whom we'll hear today. I'm also
10 very thankful to NYU for hosting this event. I do
11 think it is appropriate that we are here in New York
12 to talk about this.
13 I don't know whether Commissioner Jackson
14 is here yet. I'm very pleased that he is joining us.
15 He has spoken publicly about the need to bring
16 competition economics to the Securities and Exchange
17 Commission and, of course, is joining us today. My
18 only hope is that doesn't bog your some sort of, like,
19 interjurisdictional power grab on the part of the SEC.
20 We are older, but we're scrappy, and we don't shy from
21 a fight, so he should just know that.
22 I want to start with the traditional FTC
23 caveat, and that is the remarks that I give today are
24 my own thoughts and don't necessarily represent the
25 views of the Commission as a whole or my fellow

1 Commissioners.
2 Common ownership is an issue of particular
3 interest to me, but it probably helps to just start
4 with a little bit of a definition. Last year in front
5 of the OECD, the U.S. antitrust agencies defined
6 common ownership as "the simultaneous ownership of
7 stock in competing companies by a single investor
8 where none of the stock holdings is large enough to
9 give the owner control of any of these companies."
10 And I want to draw an important distinction.
11 Common ownership is distinct from cross ownership
12 wherein a company holds an interest in one of its
13 competitors or other joint venture or copartner
14 scenarios that have long been a focus of U.S.
15 antitrust law.
16 The most important thing for purposes of
17 today about common ownership is that it is a reality
18 of our modern economy and that it is ubiquitous.
19 Americans are increasingly utilizing the many and
20 diversified investment options that large
21 institutional asset managers offer, and the advent of
22 indexing funds has opened important avenues through
23 which average Americans can invest their retirement
24 savings, sometimes at a low or even zero price. They
25 can also have pretty good returns.

1 As a result of the growing demand for this
2 popular product, trillions of dollars that these
3 companies now manage are increasingly including shares
4 of competing companies. That's a reality. In the
5 last few years, economists and law professors have
6 raised the question whether common ownership is
7 negatively affecting competition.
8 We have a number of them here today. I see
9 Martin Schmalz sitting over here. His work with José
10 Azar and Isabel Tecu kicked off such a bevy of
11 research and commentary that it is often simply
12 referred to as “the airlines paper.” I know that's
13 not the only work, but it's sort of set the ships to
14 sea.
15 Some are concerned that common ownership
16 remedies proposed are quite dramatic. According to
17 one group of scholars who are proponents of these
18 remedies, addressing the threat of common ownership
19 would upend “the basic structure of the financial
20 sector,” for example, by limiting asset managers to
21 holding no more than 1 percent of a given industry
22 unless they do so in a purely passive manner.
23 And this debate is not just academic.
24 Antitrust enforcers around the world are watching its
25 development, as we are today, and incorporating common

1 ownership into their analyses. For instance, last
2 year, as I mentioned, the OECD held hearings on common
3 ownership, and we've seen that European antitrust
4 enforcers began citing these theories in their
5 decisions.
6 I find this debate particularly interesting
7 because it takes us to the intersection of antitrust,
8 corporate and securities law and policy. And in a
9 sense, historically, this is very fitting because in a
10 way the FTC grew out of the Bureau of Corporations at
11 the Department of Commerce.
12 When I spoke about this issue last in June,
13 I noted an important way in which the intuition behind
14 the antitrust theory of harm from common ownership
15 runs counter to the longstanding concerns of those
16 other bodies of law. Specifically, corporate law in
17 particular preoccupies itself with the principal agent
18 problem, the issue of how you get the management to
19 work on behalf of the owners of the corporation, the
20 shareholders.
21 Management neglect of shareholders -- and in
22 particular of minority shareholders -- is a particular
23 concern. And the common ownership theory -- or at
24 least one version of it -- and I'll talk about that a
25 little bit later -- is a concern that managers show

1 too much attention to shareholders and, in particular,
2 to certain minority shareholders.
3 In June, I identified several areas of
4 research that I, as an antitrust enforcer, would like
5 to see developed before shifting policy on common
6 ownership. They were, first, how common ownership
7 affects a broad group of industries; second, whether a
8 clear mechanism of harm can be identified; third, a
9 rationale why managers would put the interests of one
10 set of shareholders, in particular a minority set,
11 above the others; and, finally, a rigorous weighing of
12 the harms -- of the allegedly anticompetitive harms --
13 against all the benefits of institutional
14 shareholding.
15 So the first question stems from the fact
16 that common ownership is so ubiquitous. Is it also
17 ubiquitously causing anticompetitive harm? And if so,
18 how? Professor Menesh Patel, from whom we'll also
19 hear today, writes about the sensitivity of the harm
20 theories to various factors, including the structure
21 of a given industry.
22 We've seen some additional research since
23 June. One recent working paper examines common
24 ownership and competition in the ready-to-eat cereal
25 industry; and another looks at pay-for-delay

1 settlements in the pharmaceutical industry.
2 I understand that economists are continuing
3 to analyze the impact of common ownership in other
4 industries. These studies are critical to
5 understanding whether, and if so how, common ownership
6 might dampen competition between rivals. The better
7 the research behind our enforcement, the better our
8 enforcement will be.
9 So the second thing I asked about was to
10 identify a clear mechanism of harm. Identifying the
11 mechanism of harm, that is, how common shareholding
12 actually causes a lessening of competition, remains a
13 matter of robust debate. Some proponents of
14 predicating antitrust liability on common ownership
15 acknowledge that "the theory literature to date does
16 not identify what mechanisms funds may use to soften
17 competition." That's Fiona Scott Morton and Herbert
18 Hovenkamp.
19 Understanding the mechanism is, however,
20 critical to developing a coherent legal theory of
21 antitrust harm and ultimately to crafting an
22 appropriate remedy. To my mind, there are, in fact,
23 two competing theories of common ownership and how it
24 might lead to anticompetitive harm. And for purposes
25 of this discussion, I want to call them active and

1 passive.
2 The active theory involves managers
3 affirmatively foregoing competition. Professor Einer
4 Elhauge argues that the harm mechanism is less opaque
5 than critics claim, noting that it would include "all
6 the ordinary mechanisms by which managers are
7 incentivized to act in the interest of their
8 shareholders -- voting, executive compensation, the
9 market for corporate control, the stock market, and
10 the labor market." That's his quote.
11 He cites examples of when common ownership
12 might impact how the common owners encourage the
13 commonly owned firms to behave. Professors Ed Rock
14 and Daniel Rubinfeld, from whom we'll also hear, who
15 disagree with Professor Elhauge about the remedies,
16 offer a hypothetical of a portfolio manager who
17 cautions airline companies not to expand capacity as
18 they're coming out of an economic downturn.
19 These types of active mechanisms may look
20 like classic collusion with which antitrust law is
21 well familiar. And certainly where they involve
22 active communication, the anticompetitive conduct and
23 harm should be more easily observable. In the case of
24 a portfolio manager on a call, literally public, they
25 entail real-world affirmative action to which one can

1 point and, as such, should be covered within existing
2 antitrust jurisprudence.
3 While presumably not intended to deal with
4 competition, we have seen some asset managers
5 themselves work together to effectuate what they view
6 as social responsibility as exemplified in recent
7 reporting about principles for firearms dealers.
8 The second theory of harm is what one might
9 call the passive theory. Professor Schmalz and others
10 posit that because they "own" shares -- putting "own"
11 in quotation marks, and we'll talk about that later --
12 because they "own" shares in competing firms that
13 would all benefit from a lessening of competition,
14 common owners do not have incentives to push their
15 commonly owned firms to compete.
16 Collusion of the sort contemplated in the
17 active theory can exacerbate anticompetitive effects,
18 but it is not required for this theory of harm to
19 operate. This passive harm theory asserts that the
20 common ownership harm derives from the absence of
21 incentives from shareholders to encourage the firms in
22 which they hold the shares to compete.
23 In a sense, the anticompetitive harm
24 asserted here is only a species of an incentive
25 problem endemic to the economy, to the nature of the

1 public corporation itself. As Berle and Means long
2 ago recognized and I discussed in June, dispersing
3 ownership among numerous shareholders reduces the
4 ability and the incentive of any given shareholder to
5 attempt to exert control, such as by pressuring a firm
6 to compete more aggressively.
7 This means not only common shareholders but
8 any dispersed shareholder may have reduced incentives
9 to encourage the firm to compete. Professor Elhauge
10 notes that the benefits from softened competition may
11 also be shared more broadly among shareholders as a
12 firm increases profits, for example in an
13 oligopolistic market. So while dispersed shareholders
14 may lack an incentive to encourage competition in
15 general, that may especially be the case if we can
16 assume that they are affirmatively benefitting from
17 oligopolistic pricing and profits.
18 This passive theory raises a number of
19 interesting issues in my mind. First, it appears to
20 be in tension with some of the remedies proposed to
21 address common ownership, which offer up, for
22 instance, "pure passivity" -- not my words -- as a
23 solution. If passivity itself is the problem, it can
24 hardly be the solution as well.
25 Second, at a time of concern about a lack of

1 competition in the economy generally, is chilling
2 shareholder input the right move? Should we not be
3 considering mechanisms that would encourage companies
4 to compete? The Hart-Scott-Rodino Act explicitly
5 exempts from filing requirements acquisitions made
6 “solely for the purpose of investment,” which the
7 antitrust agencies have interpreted to mean as
8 applying to purely passive shareholders. If we don't
9 get enough encouragement to compete, is that the right
10 approach?
11 Years ago, Henry Manne explained that the
12 market for corporate control helps to rectify the
13 disparate power and incentives of firm managers and
14 shareholders and affords "to these shareholders both
15 power and protection commensurate with their interests
16 in corporate affairs." Actions that undermine the
17 effective operation of the market for corporate
18 control, including antitrust policy that fails to
19 consider this market, may prove harmful to investors
20 but also to consumers.
21 Third, how can we identify the marginal and
22 purportedly negative effects of common ownership where
23 shareholders already have little incentive to
24 encourage firms to compete more aggressively and maybe
25 even less than that given the structure of a

1 particular market, as I mentioned earlier, say an
2 oligopolistic market.
3 Consider liability under Section 7 of the
4 Clayton Act, a theory propounded in the common
5 ownership literature, where acquisitions are only
6 unlawful if they are likely substantially to lessen
7 competition. At what point do the effects of a share
8 acquisition meet that substantiality threshold?
9 Whichever theory you subscribe to or
10 scares you, I look forward to today's discussion of
11 the evidence. I'd be remiss not to mention two of
12 our hosts, Professor Hemphill and Professor Marcel
13 Kahan, who conclude thusly with regard to the
14 mechanisms of harm -- this is a quote and it's long,
15 so forgive me -- "first, several mechanisms in the
16 literature are not, in fact, empirically tested.
17 Second, some mechanisms are ineffective in raising
18 portfolio value or would pose major implementation
19 problems for CCOs [common concentrated owners].
20 Third, because most institutional CCOs have only weak
21 incentives to increase portfolio value, they are
22 likely not to benefit from pursuing mechanisms that
23 carry significant reputational costs or legal
24 liability."
25 Third, my third question from June, was

1 asking for a rationale regarding managers'
2 responsiveness to certain shareholders, and apparently
3 certain shareholders over others. This is another
4 context where the assumptions underlying common
5 ownership run up against assumptions underlying other
6 legal regimes, specifically corporate and securities
7 law.
8 If the principal-agent problem concerns you
9 and you think about shareholder neglect, or put a
10 little differently, maybe too little competition,
11 understanding how shareholders and managers behave is
12 critical to ensuring that we have coherent legal
13 regimes that accurately capture harmful behavior and
14 encourage beneficial behavior. Common ownership
15 presumes that managers are very particularly attuned
16 to the desires of a minority of their shareholders and
17 act to maximize value to them, whereas corporate law
18 assumes that managers, unless forced to behave
19 otherwise, will act to maximize their own interests
20 over that of shareholders generally and of minority
21 shareholders specifically.
22 So in a real sense, corporate law tends to
23 worry very much that managers will not be responsive
24 enough to their shareholders while common ownership
25 theories presume loyalty to select a few, often

1 passive, investors.

2 Professors Azar and Elhauge point to
3 modeling demonstrating that if managers seek to
4 maximize expected shares of votes or likelihood of
5 being reelected, then they will seek to maximize the
6 weighted average of their shareholders' profits from
7 all their shareholdings. This model also demonstrates
8 that shareholder variation in levels of common
9 ownership will "alter the precise weight managers put
10 on each shareholder."

11 But skeptics have raised questions as to the
12 practical application and real-world predictability of
13 such models. Are managers so acutely attuned to the
14 shareholding levels and desires of their various
15 shareholders? Do they respond in a precise fashion to
16 those changing shareholder levels and desires? Do
17 boards and senior managers of major companies even get
18 involved in deciding issues like pricing?

19 As noted earlier, common ownership theory
20 proponents have responded in part that noncommon
21 shareholders might likewise benefit from softer
22 competition, and so managers are not actually acting
23 against the interests of most holders. But, again,
24 if all or most shareholders benefit from soft
25 competition, such that none have incentives to

1 actively encourage a firm to be more aggressive in
2 competition, what additional impact does common
3 ownership make?
4 Much of this comes down to what shareholder
5 and manager incentives actually are. There are
6 reasons why shareholders might prefer softer
7 competition in certain circumstances, but there are
8 also reasons why they might not. For instance, if
9 they are diversified across industries as investors
10 and customers to those setting oligopoly prices, they
11 might not always benefit from oligopoly pricing in
12 discrete industries. The answer can only be complex,
13 measuring those harms against the gains to those
14 shareholders from softening competition.
15 What's an asset manager to do? To the
16 extent the answers are, in fact, nuanced, different
17 shareholders with different perspectives, different
18 preferences, different incentives changing over time,
19 to the corporate manager isn't competition the safest
20 and most legal bet?
21 Another issue. In my remarks thus far, I've
22 been a little bit irresponsible about using words like
23 "own." Some investment advisers or investment
24 managers are beneficial owners but are not the
25 economic owners of the shares. Professors Hemphill

1 and Kahan criticized “the empirical literature to date
2 [as paying] insufficient attention to the systematic
3 differences in the incentives of different investor
4 types.”
5 They find that “the empirical literature
6 fails to take account of the possibility that investor
7 types likely to be CCOs [common concentrated owners],
8 have systematically lower incentives to get involved
9 than investor types likely to be nonconcentrated
10 owners. They explain that while the literature
11 assumes the common owners' objective is to raise
12 portfolio value, the “archetypal CCO, the investment
13 advisor, has incentives quite unlike those of an
14 individual who holds the ownership stakes” and has
15 only weak incentives to increase portfolio value.
16 Consider an index fund where your goal is to
17 sort of track the index and lower fees. You're not
18 necessarily looking for higher returns than that. How
19 do these facts factor in?
20 Finally, in June, I asked for a rigorous
21 weighing of the procompetitive effects of
22 institutional shareholding. Several scholars debating
23 common ownership have acknowledged that various
24 proposals would alter "the basic structure of the
25 financial sector" and “transform the landscape of

1 institutional investing."

2 Such tectonic policy shifts should not be
3 undertaken lightly. Large institutional investors
4 have, in many ways, made investing affordable for the
5 average American. Index funds, for instance, as I
6 said earlier, sometimes have nominal to no fees, and
7 the returns are nothing at which to laugh. Such
8 investing opportunities were unheard of before the
9 second half of the 20th Century.

10 When considering policies that could find
11 index funds as they exist today are fundamentally
12 incompatible with the antitrust laws, we need to keep
13 these very real benefits in mind. Many Americans
14 simply do not have the funds available to buy into
15 more expensive investment options. Scholars have also
16 historically placed great hope in large sophisticated
17 institutional investors to have the incentives to make
18 corporate governance better. Are they doing so?

19 I look forward to hearing about stewardship
20 practices today and how their development should be
21 considered in this context. John Bogle, the inventor
22 of the index fund, wrote last week about his concern
23 that too few people control corporate governance in
24 America. Are those concerns valid? And how should
25 they factor in at all to what we're talking about

1 here?
2 This common ownership discussion has
3 remained vigorous since I last had the opportunity to
4 speak about it in June. And I am really heartened to
5 see the serious scholarship continue to examine the
6 theories and empirics at play and very pleased that
7 the FTC has included this topic in our hearings. Our
8 panelists today will grapple with a number of very
9 intriguing questions, and I'm excited to hear from
10 them all. Thank you.
11 (Applause.)
12 MR. HEMPHILL: Thank you, Commissioner
13 Phillips.
14 Our next speaker is my good friend and
15 colleague, Robert Jackson, who was sworn in in January
16 as Commissioner of the Securities and Exchange
17 Commission. He comes to the Commission from right
18 here at NYU Law, where he's a professor of law on
19 leave.
20 I can't resist noting here the deep
21 connection between the SEC and these FTC hearings. As
22 Bob Pitofsky, who I mentioned before, liked to
23 explain, it was a series of FTC hearings like these
24 that led to the creation of the SEC.
25 Previously, Commissioner Jackson served as a

1 senior policy adviser to the Department of Treasury.
2 Earlier in his career, Commissioner Jackson practiced
3 law at Wachtel Lipton & Katz. Commissioner Jackson.
4 (Applause.)
5 COMMISSIONER JACKSON: Well, thank you so
6 much to my friend and colleague Professor Hemphill
7 and to all my friends here at NYU and at the Federal
8 Trade Commission for hosting these very important
9 conversations. It's really a privilege to be back
10 here at NYU and speaking before the FTC, and I share
11 the commitment that everybody brings here this morning
12 to make sure our markets are competitive and fair for
13 all Americans.
14 Now, when I give a speech like this, I'm
15 supposed to give a caveat, which is that these are
16 my views, not the views of anybody else at the SEC,
17 but I don't even work at the FTC, so I should give
18 the further caveat of the total irrelevance of my
19 views; however, I want to point out that it's been my
20 experience that just given enough time and wisdom, all
21 my colleagues at the SEC figure out I was right all
22 along. That never happens.
23 So one of the things that's important to
24 begin here is with some history, which as Professor
25 Hemphill alluded to, back in 1933 at the adoption of

1 the ‘33 and ‘34 acts -- the ‘33 act used to be
2 enforced by this agency -- famously, the Securities
3 Division at the FTC first implemented the securities
4 laws before the creation of my agency in 1934. And
5 that's why the FTC is in a very real way and an
6 important way, both historically and intellectually,
7 the birthplace of the SEC. So it's good to be home.
8 I remarked in a recent speech about the
9 fundamental analytical mistake we've been making in
10 American securities markets to assume that we at the
11 SEC can regulate our capital markets without thinking
12 through the effects of those choices on competition.
13 I said there and I believe this morning that the FTC
14 and SEC should be working more closely together so we
15 can better oversee these markets and the exact kind of
16 issues we're discussing today.
17 In fact, the subject of today's hearing, in
18 my judgment, which is really competition and consumer
19 protection in the 21st Century, highlights the
20 compelling need for this close collaboration, and I
21 hope my appearance today marks the beginning of that
22 partnership.
23 Now, the subject of today's hearing, and
24 you'll hear about evidence all morning, is whether
25 institutional investors and primarily passive index

1 funds that hold large stakes in American public
2 companies can decrease competition and raise prices
3 for consumers. It's a critical debate on which I'll
4 explain my views shortly, but I've come here today to
5 urge all of you to think about common ownership and
6 the subject we'll discuss today and identify it for
7 what it is, which is an investor protection problem, a
8 corporate governance problem.
9 In my judgment, we're at a pivotal moment in
10 American financial history when corporate elections
11 are increasingly decided by a handful of exceptionally
12 powerful index fund managers. What's clear to me is
13 that the SEC’s current rules leave investors largely
14 in the dark about how institutional investors are
15 wielding that considerable authority. And I'm here
16 today to call on my colleagues at the SEC to pursue
17 rules that will take advantage of existing data on
18 institutional voting to empower investors with more
19 and better information on how their money is voted in
20 American corporate elections.
21 More on that in a moment, but let me begin
22 with the common ownership debate. First of all, for
23 anybody who believes, as I do, that all good research
24 scholars have an obligation to seek policy impact in
25 their work, today's hearing is an enormous victory,

1 because we're here, of course, because of
2 exceptionally important and thoughtful scholarship by
3 my friends in the academy who have done work that has
4 taught me a great deal that I didn't know about the
5 relationship between common ownership and competition.
6 Of course, the seminal piece is by José
7 Azar, Martin Schmalz, and Isabel Tecu -- an
8 extraordinary recent paper in the *Journal of Finance*
9 that demonstrates a relationship between measures of
10 common ownership and price increases in the airline
11 industry. And of course, Professor Elhauge has
12 incredibly thoughtfully moved the debate forward,
13 examining the ways in which we should be thinking
14 about those data for the enforcement of the antitrust
15 laws.
16 I commend that work to all of you, and as a
17 researcher, I can only admire the enormous scholarly
18 and policy impact that that research has had. My own
19 reaction to the work is that it presents us with a
20 puzzle and that we're at the beginning, not the end,
21 of our conversation about common ownership and what to
22 do about it. And let me say why.
23 First of all, my NYU colleagues, Professors
24 Hemphill and Kahan, in a recent paper explained the
25 difficulty with using the measures set forth in that

1 scholarship for evaluating the questions we're
2 discussing today and in particular the MHHI measure
3 and the MHHI delta measure employed in those papers.
4 And there's two things that I want to highlight in the
5 Hemphill/Kahan paper that I commend to all of you
6 that, to me, sets the agenda for moving forward with
7 scholarly work on common ownership.
8 First, as Professors Hemphill and Kahan
9 explain, there are a number of different strategies
10 that one -- that an institutional investor might
11 pursue in connection with the reduction of competition
12 in their portfolio companies. One is to eliminate
13 competition within a particular -- or reduce
14 competition within a particular firm in an industry,
15 permitting rent extraction for other firms and the
16 total value of the portfolio to rise.
17 Another is restrict production across the
18 industry, permitting rent extraction across all firms
19 of the industry. And the crucial thing to see that
20 Professors Hemphill and Kahan point out is that these
21 are two very, very different strategies from the point
22 of view of an undiversified investor. That is, one
23 will meet with approval from that undiversified
24 investor and another will be resisted.
25 To the degree that those two strategies

1 reflect completely different ways of thinking about
2 the impact of common ownership on competition, or I
3 should say the potential impact, we need new
4 scholarship that studies the difference between those
5 strategies, in particular that looks for cases where
6 an undiversified owner of the firm will resist the
7 purported anticompetitive instincts of the diversified
8 owners.
9 As Professors Hemphill and Kahan point out,
10 we don't yet have that paper. We don't yet have
11 scholarship that tackles that, and indeed as they
12 point out, I think, very importantly, the MHHI measure
13 itself is not designed to test that hypothesis. No,
14 instead, we need new scholarship with new measures
15 that test that particular difference in those two
16 strategies to see whether or not we actually have hard
17 evidence of this kind of activity in American
18 industry.
19 But much more importantly for my purposes,
20 as Professors Kahan and Hemphill point out, and as my
21 colleagues, Dan Rubinfeld and Ed Rock, have also
22 pointed out in an important paper this year in the
23 *Antitrust Law Journal*, there's very little evidence so
24 far about the precise mechanism by which such activity
25 might take place. There's a great deal of speculation

1 about how this might occur. And I find the
2 preliminary evidence on that subject extremely
3 interesting.
4 In particular, Professor Schmalz, along with
5 a group of coauthors, has a recent paper on the use of
6 relative performance measures, relative performance
7 compensation-based incentives that may or may not
8 contribute to competition in an industry. Now, as
9 someone who has studied executive compensation for
10 many years, I would love to think that it's that
11 important to competition in American industry.
12 Indeed, I'm biased to believe that a change in
13 managers' relative incentives could affect price
14 setting across American industries, because otherwise,
15 I've been wasting my life.
16 But I'm unpersuaded by the evidence we have
17 so far and here's why. Changes in incentives at the
18 top of the house in an American public company can
19 have many, many effects. I'm inclined to believe it
20 can work throughout the organization to have an effect
21 on price setting, but we don't yet have hard evidence
22 that it does so. And I would want to understand the
23 organizational design and the differences from
24 industry to industry in the price-setting authority
25 throughout a firm to better comprehend how changes in

1 relative performance incentives could have an effect
2 on prices.
3 Now, whatever you think of this evidence, as
4 I said earlier, in my view, we are at the beginning,
5 not the end, of the debate on concentrated common
6 ownership. And I took with great interest a careful
7 look at the work of Eric Posner, Fiona Scott Morton,
8 and Glen Weyl with respect to potential proposals to
9 limit diversification or to regulate institutional
10 investors in order to address the issues in this
11 literature.
12 And I must tell you, as somebody who's sworn
13 to protect investors, my sense is that the literature
14 we have today does not carry the heavy burden that a
15 commissioner sworn to protect investors should demand
16 in order to impose limitations on diversified
17 investment in American public companies. I say that
18 for many reasons, but most importantly because
19 diversified holdings have delivered an enormously
20 important product to American families who are saving
21 for retirement and education. These are the savings
22 I'm sworn to protect, and to restrict their
23 diversification would impose costs upon them that are
24 potentially enormous.
25 Also, as Professors Rock and Rubinfeld

1 pointed out, we wouldn't have even begun to
2 contemplate the effects of such a rule on other
3 industries that common ownerships might own -- that
4 concentrated common owners might own. For example, if
5 we think about the airline industry, we'd need to
6 begin to think about limits on diversification on
7 their suppliers, in others who play a role in the
8 distribution or consumption of airline activity. And
9 all of these knock-on effects, to my mind, have not
10 yet been sufficiently considered for me to be
11 supportive of a rule that would restrict
12 diversification in American investment.
13 But my concern about those proposals is not
14 so much that their burden has not been met. I don't
15 think it has. I think we're at the beginning of a
16 conversation that might someday lead to sufficient
17 evidence in that respect. But we're not yet at a
18 place where I would be comfortable with such a
19 resolution.
20 Whatever you think about that, my concern is
21 that it's distracting us from the actual issue we
22 should discuss today. To me, the particular -- the
23 issue that deserves and demands more attention than
24 it's received, both at the FTC and my agency, is the
25 fact that today institutional investors cast votes in

1 corporate elections on behalf of more than 100 million
2 American families. They wield enormous influence on
3 the future of our companies and our communities, but
4 we're not giving investors nearly enough information
5 about how their money is being voted, and because of
6 that, American investors can't make choices among
7 index funds about the way that they carry out those
8 duties. And it's time for that to change.
9 Now, the shareholder vote, we all understand
10 well, is a critical tool in setting governance
11 policies of companies and holding management
12 accountable for their actions. And that's why another
13 series of recent papers that I believe you'll hear
14 about later today, in my view, deserve as much
15 attention as the common concentrated ownership
16 scholarship you'll also be talking about.
17 In particular, Professor John Coates, my
18 corporate law professor, a fact for which he will
19 never fully be forgiven, has a recent paper
20 identifying what he calls the problem of 12. It's an
21 extraordinary paper in that it makes a very simple
22 point. Actually, it's the rare empirical paper that
23 confesses that it just picked a number out of thin
24 air.
25 Coates' point is not that there's actually

1 12 people who control Corporate America. It's that
2 that number is a realistic, reasonable ballpark of the
3 number of people who make decisions about the future
4 of American corporations, and he worries about the
5 credibility of any securities market, any product
6 market where that much power is wielded by that few
7 people, and so do I.
8 Professor Coates identifies a number of
9 particular -- potential resolutions of that problem.
10 I'll discuss them in a moment. But what he knows
11 because he's been thinking about agency problems for a
12 very long time is that the -- what's happened here is,
13 in a search for holding corporate management
14 accountable, we have transferred the potential for
15 agency problems from corporate management to
16 institutional investors who now wield the
17 extraordinary authority that Coates described in his
18 paper.
19 Indeed, with all respect to Professor
20 Coates, his insight is not new. My friends at
21 Columbia, Ron Gilson and Jeff Gordon, years ago,
22 published a paper, "The Agency Cost of Agency
23 Capitalism," that pointed out increasingly the role of
24 institutional investors in deciding about the agenda
25 items that are set by other less diversified, more

1 activist investors. And since the publication of that
2 article in the *Columbia Law Review* a few years ago,
3 that problem has grown more, not less, relevant to
4 policy debates in corporate law.
5 Now, the question is, what should we do
6 about it? And for me, the clearest path forward is
7 set by another recent paper that I commend for all of
8 you. I'm giving you a lot of homework, I realize.
9 Another recent paper by my friends, Ryan Bubb and
10 Emiliano Catan of NYU. This is an extraordinary piece
11 that takes years of data disclosed at Form N-PX, over
12 more than a decade since that form became effective at
13 the SEC, and shows the party structure of mutual fund
14 voting. What Bubb and Catan demonstrate is that we
15 can use standard models of political decision-making
16 to understand the various ways that institutional
17 investors vote.
18 They offer a model that distributes those
19 votes across three different parties of institutional
20 investors -- the managerialist party, the shareholder
21 intervention party, and the shareholder veto party.
22 Now, one thing about the Bubb and Catan paper that is
23 so striking is that we didn't know it before, that is
24 for years institutional investors had been putting
25 billions of dollars of American families' savings to

1 work in pursuit of those choices, and we just now have
2 learned the way that they're making them.
3 And that's why today I'm calling on my
4 colleagues at the SEC to put forth new rules that
5 would require better disclosure of information just
6 like that. Now, you might say to me, oh, Rob, we
7 don't need new rules, it's already in Form N-PX. And
8 I would invite you to read one and try to do the
9 difficult work an investor must do in the United
10 States today to try to understand both at the fund
11 level and at the portfolio family level the way that
12 votes are cast.
13 My sense is that Ryan and Emiliano can tell
14 you stories of many late nights spent trying to
15 decipher this form. Whatever you think about that,
16 what I'd say is it's our job at the SEC to make more
17 clear the ways that institutional investors are
18 discharging their obligations to the people that
19 they're voting for.
20 And I'm happy to say it's my impression that
21 most large institutions agree. After all, Larry Fink
22 each year publishes a clear view about what he plans
23 to do in discharging that responsibility. You can go
24 to Vanguard or Fidelity’s website. They’ll tell you
25 all about what they plan to do.

1 And my call today is for us to put that
2 information in front of American retail investors when
3 they put their money down. In my view, at the moment
4 when a retail investor makes the decision to be in a
5 particular mutual fund family, to use a particular
6 index product, they should have an understanding of
7 how their money will be voted.
8 You might be inclined to say they won't
9 care. First of all, that is -- I love to say this
10 since it gives me papers to write -- an empirical
11 question. But even if it weren't, I ask all of you to
12 keep in mind the enormously powerful ex ante effects
13 of a disclosure regime of this kind. The notion that
14 someday a retail investor at the point of sale will be
15 given salient, relevant information of the kind in the
16 Bubb/Catan paper might get institutional investors
17 thinking a little more about which party they belong
18 to and why.
19 The ex ante benefits of this kind of
20 disclosure were the basis for the ‘33 and ‘34 acts.
21 And the notion that American retail investors won't
22 read all this so it doesn’t matter, in my view is,
23 with all respect, mistaken. What I'm interested in
24 is providing institutional investors with the
25 knowledge before they cast those votes that they're

1 going to have to tell people, in salient and clear
2 terms, how they are voting Americans' money.
3 For me, that is a path to real
4 accountability for those institutional investors and a
5 beginning of an answer to Professor Coates' challenge
6 about what to do about the concentrated power that
7 institutional investors wield in the United States.
8 Let me conclude by saying how important I
9 think today's conversation is, and I feel very
10 fortunate to be here because this is exactly the way
11 policy should be made in the United States. We should
12 have researchers, like Professor Schmalz and Professor
13 Elhauge, put on the table important new questions that
14 we haven't thought enough about, offer policy
15 solutions. We should debate whether they're right or
16 wrong for the people of the United States. We should
17 demand better evidence when we need it, and we should
18 be willing to act when we have it.
19 And in my view, what we know now about
20 institutional investors in the United States is that
21 they wield a tremendous amount of influence over the
22 future of the economy in this country, and as a
23 result, we need to do better about the ways in which
24 we hold them accountable for those decisions.
25 So thanks so much to my colleagues at NYU

1 and at the FTC for holding these important hearings,
2 and I look forward to the conversation. Thank you
3 very much.
4 (Applause.)
5 MR. HEMPHILL: I've got to give them a
6 chance to finish their colloquy here.
7 Commissioner Phillips, any reactions to
8 Professor Jackson's remarks that you want to address?
9 COMMISSIONER PHILLIPS: I think my most
10 important reaction is he should send me the Catan
11 paper, which I haven't yet read.
12 COMMISSIONER JACKSON: I think we can
13 arrange that. Professor Catan is here. Actually, we
14 should just in the interest of full disclosure tell
15 them, actually, Noah leaned over and said I knew you
16 were going to try and grab power from the FTC. He's
17 right.
18 COMMISSIONER PHILLIPS: Things were good in
19 1933.
20 (Laughter.)
21 COMMISSIONER PHILLIPS: They ruined
22 everything in '34. No, I thought it was a fascinating
23 speech. I think I was struck that Commissioner
24 Jackson and I, in many respects, with respect to
25 common ownership, see things somewhat similarly. I

1 think we see similar kinds of tensions in the
2 literature -- similar kinds of questions to ask. Both
3 of us agree that we need to see more research. We're
4 both very grateful for everyone being here and for
5 this debate going on.
6 I absolutely agree that this is a better way
7 to make policy in the United States. At the very end
8 of my remarks, I alluded to the column that followed
9 on the Coates paper by John Bogle. I think those are
10 very interesting questions as well.
11 MR. HEMPHILL: Professor Jackson, any
12 reaction to Professor Phillips or to the *Wall Street*
13 *Journal* commentary from a few days ago? I'll throw
14 that in, too.
15 COMMISSIONER JACKSON: So I thought Bogle
16 was exactly right. And it's really striking from an
17 historical point of view to see this from the inventor
18 of the index fund. My own view is that the problem
19 that we have, which is that index investing has become
20 so popular as to raise this debate, is what one might
21 think of as a first-class problem.
22 I mean, we have delivered an enormously
23 valuable product to American investors that has paid
24 for untold millions of retirements, educations,
25 incredibly important. This is the way that the

1 American people access the growth in our economy, so
2 it's an enormously important product. It's become so
3 powerful, so popular, so ubiquitous that we need to
4 talk about the ways in which those who vote with that
5 money are abiding that responsibility. That seems to
6 me to be the right place for the conversation.
7 I think we also need to be very wary of the
8 emerging evidence that there might be an
9 anticompetitive effect here. Because, to the degree
10 that that case gets fully proved, I think we do need
11 to have a conversation about making sure that American
12 industries are sufficiently competitive. So I
13 continue to watch with interest as that literature
14 evolves. But my own judgment is that we're at the
15 beginning rather than the end of that conversation as
16 a matter of optimal policy.
17 MR. HEMPHILL: Well, I think with that, I'm
18 going to thank both of our -- do you want to take
19 questions?
20 COMMISSIONER JACKSON: Sure.
21 (Laughter.)
22 COMMISSIONER JACKSON: I'm happy to take
23 questions from people.
24 MR. HEMPHILL: Yes, I guess we’ll need a
25 microphone.

1 UNIDENTIFIED MALE: Well, if you have
2 questions, you should set them out on question cards,
3 and we'll bring them up you.
4 MR. HEMPHILL: And I can repeat it,
5 depending.
6 (Audience question posed off microphone.)
7 AUDIENCE MEMBER: The question is simply
8 that I agree with you. You were telling us about where
9 the focus should be (inaudible) concentration is
10 clear, the other is (inaudible). But in terms of
11 disclosure, which seems to be where you're heading
12 with respect to institutional ownership, is there any
13 thought about disclosure of conflicts of interest,
14 compensation, the time horizons that are guiding
15 institutional investors, or investor votes in general?
16 COMMISSIONER JACKSON: You want me to take
17 it?
18 COMMISSIONER PHILLIPS: Seems more your lane
19 than mine.
20 MR. HEMPHILL: This is a question posed to
21 Commissioner Jackson?
22 AUDIENCE MEMBER: Yes.
23 COMMISSIONER JACKSON: So it's a good
24 question. So let me say a few things about this.
25 First of all, because I was diving into the Bubb/Catan

1 paper, I spent some time in Form N-PX. First of all,
2 just as a matter of, like, human advice, don't. Like,
3 don't do that with your time. But what I found is
4 that it already contains some of the information.
5 Like, this is why I think the policy shift here is one
6 that makes sense. It's a very rich set of detail.
7 You can get a lot out of it. It's just
8 incomprehensible.
9 And, so, a lot of the things you're talking
10 about -- for example, incentive structure, portfolio
11 family structure, the way people are voting across the
12 organization -- if you work hard enough, it's there.
13 So my answer to your question is yes. I think those
14 things can and should be more summarily disclosed.
15 And my case for this -- for moving forward with such a
16 rule -- is that the information is already being
17 produced in the largest institutional investors. My
18 guess would be that the marginal cost of producing it
19 in a summary, more digestible fashion, in the way that
20 the Bubb/Catan paper presents, it would not be costly.
21 Now, we can have a debate over the benefits
22 of that, whether or not it would move the needle. I'm
23 happy to have that conversation. But my question to
24 your question is yes, and moreover, I don't think it
25 would be marginally as costly as everyone might

1 imagine to make that information more accessible to
2 American investors.
3 COMMISSIONER PHILLIPS: Can I just add one
4 thing to that? To me -- and I have not -- I haven't
5 read the Bubb/Catan paper. I haven't looked at any
6 one of these forms in my life.
7 COMMISSIONER JACKSON: How dare you?
8 COMMISSIONER PHILLIPS: I have read 10-Ks
9 and 10-Qs. This is a species of a longstanding,
10 ongoing discussion about how the provision of
11 information, the mandatory provision of information,
12 the amount of information, the medium of its
13 communication, and, critically for purposes of
14 Commissioner Jackson's remarks, the timing of the
15 disclosure information empowers shareholders but also
16 consumers to make decisions in the market.
17 Where you have information out there, there
18 are times where it can very easily be reflected in,
19 let's say, a liquid capital market. This is something
20 we are grappling with now with Congress in the context
21 of privacy, right? Everyone is familiar with the fact
22 that you get little popup notices that tell you how
23 the website you're visiting is going to use your
24 information. Raise your hand if you've read one.
25 Okay. And this is a very well-educated

1 group of people. So we all believe in markets, and we
2 all believe in the capacity of markets to help
3 allocate resources efficiently. Markets require
4 information. And, so, some of the most vexing
5 questions that we face is how best to feed that
6 information into those markets. It's a question of
7 how shares are voted in elections. It's a question of
8 the financials of companies. Right? That's the '33
9 act and the '34 act -- I think it was the ‘33 act.
10 It's a question in privacy. It's a broader
11 issue. And, you know, it's good to look at these
12 questions and keep up-to-date on how consumers
13 (whether they be consumers of investments or consumers
14 elsewhere in the market) assimilate information.
15 MR. HEMPHILL: So one question from the
16 audience. Could each of you say a little bit more?
17 This is a question about passive versus active. Could
18 you all say a little more about the kind of
19 fundamental differences between passive investors and
20 active investors for -- I think both of these sets of
21 issues that are on the table? Maybe we'll start with
22 you, Professor Phillips.
23 COMMISSIONER PHILLIPS: Sure, since -- that
24 was my nomenclature, so I guess I'm responsible for
25 it.

1 MR. HEMPHILL: It shows up in the
2 literature, too, to some degree.
3 COMMISSIONER PHILLIPS: So to me, the
4 critical distinction or one critical distinction has
5 to do with, if you believe that common ownership may
6 present a competition problem, or even if you simply
7 believe that it's a problem for purposes of
8 competition that all sorts of folks, whether they be
9 common owners or otherwise, don't have adequate
10 incentive to spur for management to compete, to me,
11 you need to think about what are the mechanisms for
12 spurring that competition, who are the right people to
13 do it.
14 I think as I mentioned, we need to look at
15 the various ways in which we approach -- I'm going to
16 stick in the competition policy lane -- the ways we
17 approach competition policy and always be thinking
18 about, will this chill that kind of input from
19 shareholders, or will it help shareholders encourage
20 firms to compete.
21 That is a really important dynamic in the
22 market. It's important for purposes of large asset
23 managers. It's important for purposes of smaller
24 activist investors. It's important across the board.
25 So I think to me the remedy question is really, really

1 important.

2 And also, as I said before, to me, there is
3 a big distinction if you subscribe to the active
4 theory, you support one kind of remedy. If you
5 subscribe to the passive theory, the stay passive
6 doesn't really look very attractive as a remedy.

7 MR. HEMPHILL: Rob?

8 COMMISSIONER JACKSON: So I'll take the
9 question in a slightly different direction and talk
10 about the distinction more broadly in the capital
11 markets between what we're calling activist and
12 passive investors as opposed to a particular theory
13 about the behavior of concentrated common owners.

14 You know, for me, it's been fascinating to
15 watch over the last decade the increasingly blurred
16 lines between what someone calls an active and passive
17 investor. And I'm quite sure that of all the people
18 who could decide what the difference is, I'm least
19 qualified to dictate to the marketplace what it means
20 to be truly active. Let me say why.

21 You hear a lot about activist investors and
22 the things we might do or not do. I'm not sure who
23 people mean when they focus on activists in
24 particular. But if what they mean is people who are
25 thoughtfully engaged in the governance of public

1 companies, you could very well include index fund
2 managers who are voting their shares.
3 And, indeed, I think the point that Gordon
4 and Gilson paper made years ago is that there's this
5 important interaction we don't fully understand
6 between these two types of investors. Activists play
7 an important role in agenda-setting in a way that
8 passive investors might not. But the crucial decision
9 about who wins is often left to those institutional
10 investors because they carry such sway with respect to
11 votes at large public companies.
12 In fact, if you talk to any activist,
13 they'll tell you, and the data are beginning to make
14 this clear, that what dictates the success of their
15 strategy (and I suspect increasingly the targets that
16 they choose) is the degree to which they feel they can
17 persuade those institutions, those passive
18 institutions, that they are right.
19 And, so, for me, the interaction between
20 these two types of investors is one that hasn't been
21 studied as thoroughly as it could, especially
22 empirically. I think the Gordon/Gilson paper gives us
23 a good set of testable propositions. I think it's
24 time to test them because my own sense is that we call
25 one group activist, we call another group passivist,

1 but -- and I understand fundamentally the difference
2 is that for passive investors, the sort of components
3 of the index are dictated to them by the index
4 provider, but I think it's not -- it's a distinction
5 increasingly without a difference when we think about
6 who's really wielding power in American corporate
7 elections.
8 MR. HEMPHILL: Could I take a step back just
9 for a minute? Both of you all in your remarks have
10 kind of identified an ambitious agenda -- partly an
11 ambitious agenda for research, for further work,
12 especially by empiricists, to try to make sense of
13 some of these issues. Is there anything that you all
14 see the agencies doing to play a role?
15 I mean, both the SEC and the FTC have fact-
16 finding capabilities and also strong internal research
17 teams. I just wonder if either of you could reflect a
18 little bit on whether it's more data, whether it's
19 more analytical work, internal to you all? I mean,
20 setting the agenda for the rest of us is awesome. I’m
21 just wondering, you know, what about you all?
22 COMMISSIONER PHILLIPS: It's efficient, too.
23 MR. HEMPHILL: Yeah, right. It's efficient,
24 too. Right, right. Is there -- you know, how much of
25 a role is there to play? What might that look like?

1 I mean -- do you have thoughts about that?
2 COMMISSIONER PHILLIPS: I'm going to take
3 this as the softball that you didn't intend. To me,
4 this is the start of it, right? So today we're going
5 to sit here and we're going to listen to the best
6 minds in America on a variety of different, but
7 interrelated topics talk about the state-of-the-art of
8 research, what are the questions that are unanswered,
9 and where is there agreement.
10 You know, Commissioner Jackson's call for
11 sort of other metrics would be a great example of
12 that. This is a good way of highlighting those areas
13 and aiming those resources. There are certain
14 authorities at our disposal. I will tell you there
15 are many people who think we should use authorities to
16 study a great many of topics. And, you know, we have
17 to be somewhat measured. But I think this, convening
18 folks, bringing it to the public, inviting in the
19 conversation, and inviting criticism back and forth,
20 which I hope is what we see today, is precisely the
21 way to start.
22 MR. HEMPHILL: I think we will see some of
23 that today.
24 COMMISSIONER JACKSON: Yeah, man, you're
25 going to get that for sure. So here's what I would

1 say. I think one thing that I have suggested in past
2 remarks, and the Chairman at the SEC and I have talked
3 about it and I hope we'll continue the conversation
4 about it, is joint research work between our two
5 agencies, not only because of the historical mandate
6 that we share, but because fundamentally these
7 questions can't be tackled with the data that one or
8 both -- and increasingly, frankly, when I talk to the
9 research economists at the FTC and in our house, they
10 have sort of very different data and perspectives on
11 these questions. And, so, I would like very much for
12 us to be considering joint work in the area.
13 I think putting together a task force of
14 researchers at both agencies is something worth
15 considering because you're not wrong, Scott, that we
16 gave you guys a lot of homework today -- by the way, I
17 should confess my conflict. I might be one day a guy
18 who will do that homework so it's like, yeah,
19 providing supply for my own -- it's complicated.
20 Anyway, I guess my view is that you're right
21 to push us and say, there's got to be something that
22 the agencies can do in terms of setting out agenda,
23 roundtables, et cetera, where we can do some in-house
24 work ourselves, and I think that's something we ought
25 to give a lot of thought to.

1 MR. HEMPHILL: So a question from the
2 audience. It’s a question about how to get a more
3 active aggressive corporate governance, I think. So
4 are there regulatory -- what are the kind of most
5 important regulatory or legal barriers? I mean, I
6 think the premise of the question is that a more
7 active corporate governance would be attractive. What
8 are the regulatory or legal barriers to that?
9 COMMISSIONER PHILLIPS: Well, you know, I
10 talked a little bit in my speech about an issue at
11 which I'm beginning to look, which is the impact of
12 Hart-Scott-Rodino. Hart-Scott-Rodino is a mechanism
13 to deal with antitrust issues. It doesn't go beyond
14 that. I think we need to look at mechanisms that
15 exist in the market that are either intended to or
16 have the effect of chilling shareholder input.
17 I think that's a really important principle
18 of which we can't lose sight. That, as I've said in
19 the past and I sort of reiterated today, this to me
20 has to be part of the weighing of the common ownership
21 issue, which is -- I mean antitrust liability is a
22 very powerful thing. It’s, you know, in civil
23 lawsuits, treble damages. The remedies from antitrust
24 actions can be severe. And some of the remedies that
25 are proposed for common ownership, by some of the

1 proponents of the theory, are admittedly -- would have
2 a drastic impact.
3 And I think once you -- you know, if you're
4 talking about antitrust, you're going to chill the
5 conduct that you're looking at. And that needs to be
6 part of that weighing that I mentioned. That's why I
7 called for a rigorous weighing.
8 COMMISSIONER JACKSON: Yes, so ways to have
9 more active corporate governance, how much time do you
10 have? I have ideas about that. So a few things. So
11 first of all, it's important to begin by understanding
12 the fundamental economics that an institutional
13 investor faces when they think about engaging. And
14 Lucian Bebchuk and Scott Hirst have a terrific pair of
15 papers where they walk through the incentives that
16 institutional investors have or don't have.
17 And the short version that we've understood
18 for some time now is that making those investments and
19 engagement is expensive. It's very hard to cover the
20 scope of companies that they must when they have the
21 kind of portfolio that they do. They're making those
22 investments. You can see that in the corporate
23 governance teams of the very large institutions.
24 I've spent time with those teams. They're
25 doing good work, but it's an enormous task that they

1 face. And for me, my goal as a regulator is always to
2 reduce the marginal cost of them doing that work. So
3 I want to make sure that we give them the disclosure
4 that they need, to get the information that they want
5 to cast those votes.
6 That's why, for example, I've pushed so hard
7 to finish the disclosure rules on executive
8 compensation of corporate governance under Dodd-Frank.
9 Those -- that statute's eight years old. We haven't
10 finalized the majority of those rules. That's
11 information that institutional investors have to go
12 out on their own to get. It costs them money on the
13 margin to do that. It makes them less likely to be
14 actively engaged in corporate governance. It's just a
15 fact.
16 Also, I think we should be looking at other
17 ways to reward institutional investors and make it
18 possible for them to access channels of engaging with
19 the company. So just to give an example, there's
20 increasingly proxy access proposals that have been
21 adopted at public companies that provide some
22 realistic path for institutional investors to actually
23 have a contested election at a public company.
24 I really feel like the case for the
25 universal proxy proposal that was put forth at the SEC

1 before the new administration took place is very
2 powerful. And like Commissioner Phillips, to me,
3 these things are all related, because he's right, to
4 the degree you say that we're worried about antitrust,
5 not only do the basic economics of institutional
6 investing make it difficult for these folks to engage
7 in the margin, but it raises the specter of too much
8 engagement producing liability under the antitrust
9 laws, which I worry deters very beneficial oversight
10 of corporate management.
11 MR. HEMPHILL: So does the homework that
12 you all have given us potentially do that a little
13 bit? Right? I mean, should we be worried about
14 institutional investors turning tail because, look,
15 we're talking through the possibility that we've had
16 this walking antitrust violation for some time, the
17 cure to which is to do less governance?
18 COMMISSIONER JACKSON: Oh, for -- so, that's
19 --
20 MR. HEMPHILL: I mean, how strongly should
21 we take that?
22 COMMISSIONER JACKSON: I think that's a very
23 real cost. I think those who have advanced those
24 proposals have acknowledged that cost, that there is
25 some downside to raising the specter of antitrust

1 liability because to the degree you get too much
2 engagement from an institutional investor, it provides
3 evidence of that kind of influence that might raise
4 questions from an antitrust point of view.
5 And as a scholar of corporate governance, I
6 worry about -- here's what I want to say. I don't
7 want to go too far down the road of a false choice,
8 because we can empower institutional investors to
9 engage and act and still be mindful of and pay close
10 attention to the degrees to which they use those
11 channels, or don't use those channels, to reduce
12 competition.
13 I don't think we have to choose between
14 effective corporate governance and reduced competition
15 in the United States, but I do worry -- and here's my
16 real frustration. There are already tools at our
17 business disposal to provide better disclosure on
18 executive pay, finish the rules that we’ve got, do
19 universal proxy. There are already tools that would
20 allow us to do that, and I think it's time for us at
21 the SEC to start taking that seriously.
22 MR. HEMPHILL: So another question from the
23 audience, and I might need a little bit of help just
24 clarifying it. I think the question is essentially
25 about who are these people that are voting the shares?

1 Just trying to get educated on -- how many people are
2 actually voting these institutional investors' shares?
3 Who are they within the organization? I think to just
4 get a little more educated about that.
5 COMMISSIONER PHILLIPS: So not to step on
6 what Commissioner Jackson was saying, I think part of
7 what he was pointing out is this is an area where we
8 are beginning to learn a little bit more. We're
9 beginning to learn about the dynamic. I expect that
10 we are going to hear today some description of, like,
11 at-large institutional asset managers, how stewardship
12 works, like what that process actually is.
13 COMMISSIONER JACKSON: Yeah, I think that's
14 right. And actually just to point out a really
15 interesting and important dynamic, even in the
16 empirical literature, I mentioned the Bubb/Catan
17 paper, there's a debate about the right unit of
18 measurement for casting votes. Should it occur at the
19 fund family at the portfolio level, the fund family
20 level? There's another paper that takes a different
21 approach for all kinds of interesting reasons.
22 Just to give you a sense, these are brand-
23 new, cutting-edge emerging papers that are debating at
24 what level are these votes cast. So that's why I say
25 we're sort of at the beginning of the conversation.

1 Also, by the way, Scott, I would predict
2 heterogeneity among institutions with respect to the
3 kind of group that they put together, who actually
4 wields power in that group. Is it the portfolio
5 manager? Is it someone just above them in the
6 organizational hierarchy? You know, I think my
7 understanding, when I talk to people, is that there's
8 heterogeneity even with respect to that authority.
9 And that's something that the literature's just now
10 beginning to understand.
11 COMMISSIONER PHILLIPS: And just to add one
12 thing, and this was alluded to earlier. There are
13 also players outside of the institutional asset
14 managers themselves. Right? There are other
15 investors who may communicate with them. There are
16 proxy advisers. There is a broader universe of folks
17 involved in that kind of decision-making.
18 COMMISSIONER JACKSON: Man, I just want to
19 point out, we got down to six minutes left and almost
20 made it without mentioning ISS.
21 (Laughter.)
22 COMMISSIONER JACKSON: I was like so -- I'm
23 still waiting for the day where I do something on --
24 and -- yeah, that's right. There are other players in
25 this ecosystem. It's worth thinking and talking

1 about. And we're having -- actually at the SEC, to
2 the Chairman's great credit, we had a really
3 interesting roundtable discussion of those issues a
4 couple of weeks ago. And I really think my colleagues
5 on the Commission are thinking hard about these
6 questions, which is why it's such a good moment for a
7 conversation like today's.
8 MR. HEMPHILL: So one other question from
9 the audience I think is picking up the theme of
10 heterogeneity that you guys were just talking about
11 and wanting to focus attention for a minute on index
12 fund managers, right? Diversified portfolio, not just
13 within an industry, public companies in an industry,
14 but across industries, in some sense approximating the
15 whole economy.
16 So the question is whether we should really
17 worry about index funds to the extent that they own
18 not just the competitors but also the suppliers and
19 also to some degree depending -- you know, the
20 customers. How does that change how we think if it
21 does? How does it change how we think about that kind
22 of institutional investor?
23 COMMISSIONER PHILLIPS: Well, to me,
24 especially for purposes of the antitrust discussion,
25 this is part of the nuance into which we have to get.

1 You know, I think -- take a hostile merger, right? If
2 you worry about too much power invested in an
3 institution generally for purposes along the line of
4 Coates and Bogle's argument, if you worry about
5 antitrust liability, part of what you may have in mind
6 is the notion that the asset manager just thinks
7 generally or about itself broadly.
8 Take a contest where the shares are held in
9 companies that don't have a shared interest. How are
10 they being voted? Right? Are they being voted the
11 same way? Because if they're voting against
12 themselves, they may not be operating in the way that
13 we might think of someone who just owns a lot of
14 shares voting unilaterally.
15 I think those dynamics and those nuances
16 are critical to understand. The leveling of the sort
17 of supply chain that you not only have an interest in
18 one company but in the companies from which that
19 company buys and the companies to which that company
20 sells, that is another level of nuance in terms of
21 understanding what the sort of broad asset manager
22 interest might be.
23 COMMISSIONER JACKSON: Yeah, I think that's
24 right. I mean, one of the -- I mean, look, this is
25 why the Azar and the Elhauge papers are so interesting

1 and important because when I begin to try to think
2 through, if you're an institutional investor and you
3 want to reduce competition, how do you think about
4 that across your entire portfolio, not just in an
5 industry? How do you think about the suppliers,
6 customers, et cetera?
7 It's an enormously complicated calculus.
8 It's not -- one of the things that the literature has
9 done for me is clarified what the objective function
10 might be in that situation, what they might be trying
11 to do. So what we could meaningfully put on the left-
12 hand side in terms of what the institutions might be
13 trying to achieve.
14 Look, I think he's right that it's a good
15 thing to start with understanding the various calculus
16 that one might do if they exercise that influence.
17 And then I think, as your paper points out, what we
18 really want is to make sure we have a measure that
19 tests that strategy. And I think that's where the
20 literature, I hope, is going.
21 And the more recent paper on relative
22 performance incentives, I think, takes a big step in
23 that direction, really has given me a lot of food for
24 thought about, okay, now, that helps me understand
25 what the thesis might be, right, because these guys

1 are paid for exceptional within-industry performance,
2 so maybe that's a mechanism we can think through.
3 So understanding the basic economics of what
4 a concentrated common owner strategy might be is I
5 think where we need to go in terms of understanding
6 this literature better.
7 MR. HEMPHILL: Any closing thoughts? Can I
8 give a minute to each of you all if there's anything
9 you want to close with?
10 COMMISSIONER PHILLIPS: I just want to close
11 with my real enthusiasm. I have booked my train late
12 enough to stay for as much of today as I can. I think
13 this is going to be one of the most interesting
14 debates. I think we are, like, literally and
15 physically at the intersection of two very interesting
16 areas of law, both of which focus on markets and their
17 optimal functioning. So I just want to thank really
18 everyone for being here with us.
19 COMMISSIONER JACKSON: Yeah, I certainly
20 agree. I think this is the case for research. This
21 is why research is so important to me. I mean, we're
22 here because Martin and Einer and others sort of put
23 this issue front and center for us and are making us
24 think hard about it. And, so, as someone who was a
25 researcher, now a policymaker, it's rewarding for me

1 to see the payoff of that research.
2 And when I say we're at the beginning of the
3 conversation, I mean, I'm not only trying to give you
4 guys more papers to write, I'm also learning in a very
5 real way about the ways that I should think about
6 doing my job well. So I'm very grateful to all of you
7 for that, and I very much look forward to the
8 conversation.
9 MR. HEMPHILL: Great. With that, please
10 join me in thanking Commissioner Phillips and
11 Commissioner Jackson.
12 (Applause.)
13 (Recess.)
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23 **INSTITUTIONAL INVESTORS, DIVERSIFICATION, AND**
24 **CORPORATE GOVERNANCE**
25 MR. ROCK: Welcome back. I'm Edward Rock.

1 I teach here at the law school. And it is really
2 terrific to have this session here. The common
3 ownership issue is one that folks here have been
4 thinking about deeply for quite a while, so it's fun
5 to have the session here.
6 I want to say a word about how this panel
7 fits into the overall structure of the program today.
8 Commissioner Phillips and Commissioner Jackson have
9 introduced us to the issue and the to tension, to the
10 tension between antitrust liability and corporate
11 governance, to the intersection between antitrust and
12 corporate governance. And it's really a -- part of
13 what is so interesting about this set of issues is
14 looking at the intersection of antitrust and corporate
15 governance. Something that is not often done but is
16 extremely important.
17 The claim, as you heard this morning, as
18 you'll hear more this afternoon, the claim that Martin
19 Schmalz and coauthors have made is that the structure
20 of common ownership through some mechanism has had
21 competitive effects. Einer has argued that it's
22 currently -- it's currently illegal under Section 7 of
23 the Clayton Act, and Eric Posner and Fiona Scott
24 Morton and Glen Weyl have argued that the appropriate
25 solution is to either force firms to choose one firm

1 in a concentrated industry or limit them to 1 percent
2 or force them to commit to complete governance
3 passivity.
4 This then sets up the framework for this
5 panel, which is what would be lost if either through
6 antitrust risk, antitrust exposure firms opted for
7 governance passivity? What would be lost if the
8 Posner/Scott Morton/Weyl proposal were adopted in
9 firms in order to maintain their business model, opted
10 for governance passivity, opted to put their shares in
11 the drawer and to return to the kind of lack of
12 shareholder engagement in corporate governance that
13 characterized the '50s, the 60s, and really well into
14 the '70s and '80s?
15 So a big part of what we're trying to do
16 today is to provide a snapshot of what shareholder
17 involvement in corporate governance looks like in
18 2018. What the ordinary sort of engagement is, how it
19 works, who initiates it, so that we can see what would
20 be lost if common owners returned to passivity.
21 Another issue you heard in both Commissioner
22 Phillips' talk and Commissioner Jackson's talk is this
23 question of what are the mechanisms by which this
24 anticompetitive effect could happen, could come about?
25 And, again, this panel, by talking about what is the

1 nature of shareholder engagement in corporate
2 governance in 2018, can cast light on how plausible
3 different proposed mechanisms are, how plausible the
4 lobbying mechanism is, how plausible is it that the
5 large institutional investors in meeting with
6 corporate management are urging them to adopt the soft
7 competition approach?
8 How plausible is it that the mechanism of
9 reducing the amount of relative performance evaluation
10 compensation or having, to put it more positively, to
11 having greater emphasis on industry profits, industry
12 performance compensation? Is it a plausible channel
13 by which competition could be restrained?
14 In preparing for the panel, I've asked folks
15 to address a variety of issues, including how do asset
16 managers initiate the engagement? Just how does it
17 work? What are the topics of engagement? To what
18 degree is it firm-specific? To what degree is it
19 market-wide? In engagements, what are the -- what do
20 asset managers raise or touch on? Do they touch on
21 the sort of issues that are proposed to be the
22 mechanism by which the views in favor of soft
23 competition that are attributed to the common owners
24 get translated into corporate policy?
25 Let me briefly introduce the panel in order

1 of presentation. You have the biographies that tell
2 you much more about their distinguished backgrounds.
3 Our first presenter will be Barbara Novick, who is a
4 cofounder of BlackRock, is a Vice Chair and now
5 oversees -- among her varieties of duties, oversees
6 investment stewardship.
7 We'll then turn to Allison Bennington, who
8 is a partner at ValueAct but I should emphasize is not
9 here in that capacity. She's also a member of the SEC
10 Advisory Committee, a member of the Steering Committee
11 at the Investor Stewardship Group and a member of the
12 Advisory Board of NYU's Institute for Corporate
13 Governance and Finance. And in those capacities,
14 Allison sees and interacts with a wide variety of
15 different kinds of investors and is very much involved
16 in understanding and in crafting the approach that
17 different kinds of investors take to corporate
18 governance.
19 We'll then turn to Ken Bertsch, who is the
20 Executive Director of the Council of Institutional
21 Investors, which is the organization of which many of
22 the largest institutional investors gather.
23 Our next speaker will be Heather Slavkin
24 Corzo, who is the Director of Capital Markets Policy
25 for the AFL-CIO. The AFL-CIO has been very involved

1 in corporate governance for decades now.
2 Following Heather, we'll have Holly Gregory,
3 who's Co-Chair of Sidley Austin’s Corporate Governance
4 Practice and is an experienced board counselor and can
5 take us inside the boardroom to see how shareholder
6 engagement looks from the perspective of the
7 directors.
8 We'll then turn to David Hirschmann, who's
9 Executive Vice President of U.S. Chamber of Commerce.
10 And we will close our first round with Scott
11 Hirst, Associate Professor of Law at BU and the author
12 with Lucian Bebchuk of a very important recent paper
13 that gathers data that looks at how much involvement
14 in corporate governance institutional investors have.
15 The takeaway -- Scott and Lucian's takeaway -- is much
16 too little. They should do much more, which
17 immediately sets up the tension that characterizes
18 today.
19 It used to be that corporate law scholars
20 divided between those who thought that institutional
21 investors didn't do anything and those who thought
22 that institutional investors did a little bit. With
23 Martin and his coauthors' work, we now get all three
24 positions -- potential positions on the spectrum.
25 There are those who think that institutional investors

1 do too little, like Scott and Lucian. There are those
2 like Martin who think they do too much. And there are
3 those like Marcel Kahan and myself who think it's sort
4 of about right.
5 With that, let me turn it over to Barbara.
6 Here's the clicker.
7 MS. NOVICK: Good morning. I'd like to talk
8 about investment stewardship. This is the critical
9 element of the corporate accountability chain that
10 empowers shareholders to engage, to vote on issues
11 that are relevant to the long-term success of the
12 companies that we own on behalf of our clients. It's
13 the very essence of how shareholders can exercise
14 their rights.
15 It clearly matters to asset owners, who are
16 the economic owners of the shares, as they participate
17 directly in the fortunes of the company. It also
18 matters to the asset managers who are fiduciary agents
19 on behalf of those clients, earning a small basis
20 point fee on the total portfolio.
21 Voting in proxies is one of the primary ways
22 that shareholders can express those views. Many asset
23 owners choose to vote themselves. This includes both
24 asset owners who manage assets in-house and asset
25 owners who outsource to asset managers. When the

1 asset manager has the authority to vote, stewardship
2 codes and regulation not only encourage but very often
3 require that they do so on behalf of the clients.
4 And, of course, as you heard earlier, many asset
5 owners and asset managers use proxy advisers to assist
6 them.
7 The common ownership debate is not about
8 active versus passive. If the theory has any value at
9 all, it would logically apply to any investment
10 strategy in which an investor holds more than one
11 company. Investment strategies are best thought of as
12 a continuum from the most actively managed to the most
13 indexed-oriented, all of which may include multiple
14 companies in a given sector.
15 Stock indexes are a crucial component to the
16 underlying both index and active strategies. Index
17 strategies are designed to closely track the
18 performance of the index by tracking the composition
19 of the index. These strategies have grown
20 significantly as they provide the average investor
21 with low-cost access to market returns. Active
22 strategies by contrast are intended to outperform the
23 index by deviating from its competition.
24 One of the suggested remedies for common
25 ownership is to limit portfolios to one company per

1 sector. In that case, virtually all diversified
2 portfolios would no longer be viable. Index providers
3 are a key participant in the ecosystem. Companies
4 such as S&P and MSCI create indexes that represent
5 broad markets as well as specific sectors and
6 geographies using a variety of methodologies.
7 Understanding stock inclusion rules and
8 index rebalancings is essential to managing
9 portfolios. The often-cited airlines paper assumes
10 that managers continue to hold airlines during periods
11 of bankruptcy, but the reality is quite different.
12 When a company declares bankruptcy, its stock is
13 delisted from the Exchange, and index providers
14 promptly remove that stock from the index.
15 In contrast, when a company exits
16 bankruptcy, there could be a significant lag before
17 the stock is returned to the index. In the case of
18 U.S. Airways, the stock was excluded from the index
19 for over four years. As a rule, index managers sell
20 and buy the stocks close to the timing of these
21 deletions and additions. In the case of the airline
22 paper, 29 of the 56 quarters -- that's half -- of the
23 study period are impacted by this incorrect
24 assumption.
25 Investment stewardship includes both

1 engagement and voting. Keeping in mind that a
2 company's board represents its shareholders, the
3 primary focus of engagement is on governance issues as
4 the quality involvement of the board is paramount to
5 representing shareholders' interests. In addition to
6 board governance, we have engaged with companies to
7 understand their long-term strategy, to assess the
8 alignment of executive compensation with shareholders,
9 to encourage climate risk disclosure, and to
10 understand how a company is addressing human capital
11 management.
12 You'll notice it was never about product
13 pricing. And while we like to think our opinion
14 matters, we represent a minority of the shares
15 outstanding, generally in the single digits, so there
16 is a limit to how much our opinion matters.
17 Let me touch briefly on compensation. When
18 our stewardship team evaluates executive compensation,
19 we start from the premise that boards and their
20 compensation committees should set policies that are
21 aligned with the company long-term strategy.
22 Compensation consultants play a key role in designing
23 these plans, and these plans are based on own firm
24 performance as measured by metrics like pre-tax
25 income, margin improvement, shareholder returns, and,

1 frankly, outperforming their competitors.
2 Proponents of common ownership believe that
3 the presence of common owners incentivizes company
4 executives to reduce competition. This would mean
5 that CEOs are willing to place the minority interests
6 of common owners above their own personal financial
7 interests since many are paid in company stock.
8 There's a broad consensus amongst
9 policymakers and asset owners that traditional asset
10 managers should take a serious approach to investment
11 stewardship of client assets. Stewardship codes and
12 other regulations encourage engagement and often
13 require the asset manager to vote in proxies. Over
14 the past two decades, a series of codes have been
15 issued from the U.K. to Australia to Japan and more.
16 We count close to 20 stewardship codes globally today.
17 In the U.S., both the SEC and the DOL issued
18 guidance 15 to 20 years ago stating that, as
19 fiduciaries, fund managers must vote proxies when
20 doing so is in the best interest of clients. Calls by
21 some commentators to restrict engagement or eliminate
22 proxy voting rights directly contradict the
23 stewardship codes and regulations. Restricting voting
24 would disenfranchise our clients, the asset owners.
25 The result could be an entrenchment of management or

1 empowering short-term actors, both at the expense of
2 the long-term owners.
3 At BlackRock, we evaluate each ballot item
4 on its merits in the context of materiality to the
5 company's long-term financial performance. We believe
6 voting is the ultimate expression of investment
7 stewardship, and a vote against management reflects a
8 failure to make progress in engagement.
9 In 2017, 98 percent of the 28,000 ballot
10 items from companies in the Russell 3000 Index were
11 management proposals, things like election of
12 directors or reappointment of auditors, which are
13 generally considered routine items and receive more
14 than 95 percent in favor. The exception are say-on-
15 pay votes, which often get lower support, especially
16 if the proxy advisory firms have recommended against.
17 The remaining 2 percent of the ballot items
18 are shareholder proposals. Roughly half of these are
19 for environmental and social issues. As you can see,
20 the voting on these items has no particular pattern
21 across managers. ISS uses over 380 management agenda
22 codes to categorize voting items for their proxy
23 reports. Not even one agenda code relates to product
24 pricing. The chart also highlights the proxy advisers
25 and their recommendations. Various studies estimate

1 that proxy advisers influence between 10 and 25
2 percent of the vote. This far exceeds the influence
3 of any individual or even multiple asset managers.
4 Given their influence in voting, any study on
5 shareholder voting must incorporate this effect.
6 However, it is completely ignored in the common
7 ownership papers.
8 So let me wrap up. The stewardship
9 ecosystem, as you've seen, is complex, many different
10 participants. Asset managers are there to provide
11 investors with diversified portfolios to meet their
12 investment needs. And we engage with portfolio
13 companies not to influence pricing but rather to
14 protect and enhance the retirement outcomes of our
15 clients. This engagement plays an important role in
16 the corporate accountability chain, which has value,
17 not just for shareholders, but for society as a whole.
18 Thank you.
19 MR. ROCK: Thank you, Barbara.
20 Allison?
21 MS. BENNINGTON: Thank you, Ed. Good
22 morning, Commissioner Phillips and Commissioner
23 Jackson. The lights are bright. I don't know where
24 you are, but thank you. And thank you to NYU and the
25 FTC for inviting me to participate in this panel today

1 on such an important topic with such an August group
2 of fellow panelists.
3 So let me start with that same disclaimer
4 that my remarks today are entirely my own opinion and
5 not that of ValueAct Capital.
6 So, today, what I'd like to discuss is the
7 recent history of engagement between corporations and
8 their shareholders -- what we call corporate
9 governance -- what corporate governance achieves and
10 what would be lost to the savers, retirees, and
11 investors of this country if the approaches suggested
12 by some in the academic community were to be adopted
13 by the FTC.
14 So first a history. The recent history of
15 corporate governance starts with the financial crisis
16 beginning in 2008. Before the financial crisis,
17 shareholders as a group tended to be more passive, and
18 management and boards were dominant. The balance of
19 power was firmly on the side of corporations.
20 Shareholders trusted that management would do the
21 right thing and ceded long-term corporate strategy and
22 direction to management and the board.
23 Effectively, it was as if shareholders put
24 their shares in the drawer and only took them out when
25 it was time to sell. But then the whole world

1 changed. In 2008, the financial crisis struck, and
2 over the next few years, trillions of dollars were
3 erased from the savings and retirement accounts of
4 American workers and savers. People who had saved for
5 a lifetime for retirement lost huge portions of their
6 savings or had to work for many more years before they
7 could retire on much less than they had planned.
8 Parents could no longer afford college
9 tuition; and household net worth was slashed. Almost
10 every American was negatively impacted by the
11 financial crisis, none more than retirees, workers,
12 savers, and investors. A lot of these savings and
13 retirement funds were invested through mutual funds or
14 index funds, which I'm loosely calling asset managers.
15 I know I don't have these precisely right, but just to
16 give an overall sense, which in turn invested in the
17 shares of U.S. corporations.
18 Many union and public pension funds, what
19 I'm calling asset owners, managed the pension
20 contributions of their workers and also invested in
21 U.S. corporations. The financial crash was an
22 enormous wake-up call for these asset managers and
23 asset owners. Workers and savers and retirees thought
24 their savings were safe and that someone was looking
25 out for them. But asset owners and asset managers

1 thought their investments in U.S. companies were safe
2 and that managers and boards were not taking excessive
3 risks.
4 At that point, asset owners and asset
5 managers, which I'm going to call collectively
6 institutional investors, realized that in order to
7 fulfill their fiduciary obligations they had to take a
8 role in corporate risk management and keep an eye on
9 the long-term health of U.S. public corporations that
10 they were investing in. They invested time and effort
11 in establishing a set of protocols to engage with
12 company management and boards of directors. And this
13 is when the balance of power began to shift.
14 Shareholders insisted that their voices be
15 heard, and a new wave of engagement between
16 corporations and these institutional shareholders
17 began, which, for lack of a better term, we loosely
18 call corporate governance.
19 Then in 2010, the Dodd-Frank Act was
20 enacted. Dodd-Frank had multiple provisions,
21 encouraging shareholder corporate engagement and
22 provided an important congressional endorsement of the
23 role of shareholders in corporate governance.
24 I'd like to just take a little detour to the
25 SEC, and thanks to Commissioner Jackson, I feel it's

1 okay to do so. The SEC is the regulator of both the
2 financial markets and also the U.S. corporations. So
3 when the SEC speaks, the entire U.S. capital and
4 corporate ecosystem listens. And when the SEC
5 encouraged and continues to encourage shareholder
6 engagement with public companies -- I'll just give you
7 a few quotes from Commissioner Kara Stein: I would
8 posit that the entire corporate ecosystem success
9 actually rests on effective communication and
10 collaboration between corporations and their
11 shareholders. When a company, its management, its
12 shareholders, and its employees work together,
13 companies tend to be more resilient and prosperous.
14 In turn, this benefits companies, their corporate
15 stakeholders, and the economy as a whole.
16 Ex-Chairman Mary Schapiro: As a general
17 rule, interested, aware, and active shareholders are
18 good for public companies, and I believe that more
19 shareholder engagement is better.
20 And, finally, Commissioner Luis Aguilar: In
21 the end, I firmly believe that companies with
22 corporate governance processes that enhance how they
23 engage with their owners will be more successful than
24 those that keep the door shut.
25 So what does this all boil down to? It

1 boils down to accountability through corporate
2 governance. Any system without accountability
3 eventually fails. Some argue that the financial
4 crisis was caused in part by a cascade of failures in
5 accountability at multiple points in the greater
6 financial ecosystem, and public corporations certainly
7 played their part.
8 In the new world of corporate governance,
9 the very clean and clear system of accountability has
10 established itself, a system where everybody is
11 accountable, everyone has a boss. Here’s how it
12 works. Employees are accountable to management.
13 Management is accountable to the board. The board
14 is elected by, and therefore accountable to, its
15 shareholders. There are many different types of
16 shareholders, but when we’re talking about
17 institutional shareholders, institutional shareholders
18 are accounted to those whose financial assets they
19 look after.
20 So who’s at the end of that chain? The
21 retirees, savers, workers, union members, investors.
22 The chain of accountability between management and
23 boards and their shareholders is facilitated by
24 corporate governance, and it's the institutional
25 shareholders that have taken the lead in the corporate

1 governance engagement process.
2 If we adopt the suggestions of some in the
3 academic community, institutional shareholder
4 engagement will be choked off. The chain of
5 accountability will be broken between the board and
6 the vast majority of their shareholders. Boards will
7 no longer have a boss, and the rest of the chain will
8 be decoupled. And it's the retirees, savers, workers,
9 and investors who are at the end of that chain who
10 will suffer the consequences.
11 I'm sure that many of my fellow panelists
12 will go into more detail about the topics of
13 engagement between shareholders and management, but
14 the overarching theme is that institutional
15 shareholders want to see their companies run in a way
16 that allows them to assess long-term goals. No
17 shareholder wants to see a company they are invested
18 in on the front page of the *Wall Street Journal*
19 because of irresponsible corporate conduct that
20 results in the destruction of shareholder value.
21 So where does this leave us, and what would
22 be lost if shareholders were blocked from engagement?
23 We’ve seen what happens when the chain of
24 accountability is broken. I would posit that the
25 healthiest ecosystems are the ones where everyone is

1 accountable. Ultimately, this chain of accountability
2 protects the very people who the academic community is
3 concerned about hurting. Consumers by one name are
4 also workers, union members, retirees, and savers by
5 another.
6 Muzzling shareholders and swinging the
7 pendulum back in the direction of management creates a
8 worrying scenario. As a country, we have been there
9 before. Our financial system's regulators and
10 congressional leaders have led us in the right
11 direction of developing an open shareholder/management
12 relationship. In my opinion, we should very seriously
13 consider the implications or unintended consequences
14 of a shift in antitrust policy that could have major,
15 far-reaching implications for established capital
16 markets policies and practices that have served us all
17 well. Thank you.
18 MR. ROCK: Thank you, Allison.
19 Ken.
20 MR. BERTSCH: Thanks, Ed. Thank you for
21 inviting me to participate. Thank you, Commissioner
22 Phillips and the FTC. I think it's a very interesting
23 day, and it's already gotten an interesting start.
24 So my name is Ken Bertsch. I'm Executive
25 Director of the Council of Institutional Investors.

1 We are a membership organization of organizations.
2 Our core membership, are asset owners, institutional
3 asset owners, particularly public pension funds. We
4 were set up by public funds in the mid-1980s actually
5 to try to fix what was wrong with corporate
6 governance, which was lack of engagement by long-term
7 shareholders with the companies that they owned, and
8 I'll come back around to that.
9 I do want to make a few comments on the
10 dialogue earlier with Commissioners Phillips and
11 Jackson, which I thought -- pretty much would identify
12 myself with all of their comments. I did learn ever
13 more that NYU is the center of the world, although
14 probably the business school as well as law, I'd have
15 to say.
16 And I remembered that I worked at TI -- what
17 was then called TIAA-CREF in the late 1990s and early
18 2000s, and we had a corporate engagement program that
19 I think was somewhat groundbreaking. I had a staff of
20 two retired CEOs, which was kind of a unique
21 perspective. We had a pretty vigorous program, and we
22 had Chancellor Bill Allen, who by that time was
23 working with NYU to come in and evaluate what we were
24 doing and particularly to look for agency problems,
25 and were we actually doing activities that were

1 worthwhile for the beneficiaries. And he did quite a
2 thorough review. He was largely positive. He had
3 some criticisms, but it occurs to me -- it only
4 occurred to me this morning that might be some kind of
5 exercise that's worth doing based on Commissioner
6 Jackson's comments.
7 I would also say that some of the comments
8 were really about getting information to retail
9 holders on stewardship programs in a way that they
10 would understand. I would say that the institutional
11 asset members, many of them, have had a lot of
12 interactions with their asset managers about
13 stewardship for a while. And, so, there are models
14 out there. There are folks who are pushing the
15 envelope. I'd cite in particular the GPIF, the
16 largest pension fund in the world in Japan, which has
17 in the last couple of years really further developed
18 how to interact with asset managers on the subject.
19 Third, I want to identify myself with
20 Commissioner Phillips' remarks about chilling effects
21 and worrying about chilling effects. I worry about
22 chilling effects from actually the common ownership
23 debate itself to some extent, but also would say the
24 current HSR rules are -- the too narrow investment-
25 only exemption and too ill-defined investment-only

1 exemption, I think actually is right now chilling some
2 of the engagement that needs to take place, is on the
3 liability side from the standpoint of law departments
4 and asset managers that weigh whether -- whether there
5 should be engagement or not.
6 I also want to associate myself with both
7 Commissioners on the heterogeneity of the participants
8 in this on the investor side. So on the asset manager
9 level, I really see all kinds of different variety of
10 interactions. Big indexers have varying levels of
11 fundamental active investment that they're doing at
12 TIAA. We involved our portfolio managers where they
13 had -- at some companies where they had positive
14 weightings, but we were largely indexed, and so we
15 worked mostly in a similar way that BlackRock did.
16 Active managers have different combinations
17 of involving corporate governance staff and portfolio
18 management staff, and it’s changed rapidly in recent
19 years. The corporate governance discussions tend to
20 be on process, with investors trying to understand do
21 we have faith in this board, are they awake at the
22 switch, do they understand how the executive
23 compensation works. And there are discussions about
24 risk management and so on.
25 Those are the topics that are at the

1 forefront. For active managers -- and strategies
2 discussed, but it’s more does this board, does this
3 board member understand the strategy, can they
4 articulate it to us, and how does it connect to
5 executive compensation, for example.
6 For more active owners, I think there’s more
7 dialogue, no doubt, about strategy, particularly where
8 companies are misfiring. But the measure of whether
9 they're misfiring has been are they doing poorly
10 relative to peers. Are they missing the boat on
11 strategic change? And those discussions, and I have
12 been in some of those as well, including at Morgan
13 Stanley Investment Management, where I worked.
14 To the extent they get into execution, it's
15 really about running faster, jumping higher, competing
16 more -- better, becoming better competitors. So in
17 that sense, some of the common ownership debate
18 doesn’t ring true to me in terms of what these
19 discussions actually are about.
20 I also would say there’s a little bit of
21 tone deafness, I think, in some of the articles about
22 what goes in asset management firms. Ed, your paper,
23 just a trivial example, that picks up the commentary
24 that some investors admitted to engaging with
25 companies, using the word sort of an "admission

1 against interest," that is not an admission against
2 interest. It's probably exaggerated, actually.
3 The admission against interest would be that
4 we're not engaging because --
5 MR. ROCK: That was a quote -- that was a
6 quote from a different paper. That wasn't --
7 MR. BERTSCH: No, no, I know, but you found
8 it.
9 MR. ROCK: We found it.
10 MR. BERTSCH: It was not Ed's paper.
11 (Laughter.)
12 MR. BERTSCH: It was a paper he was
13 critiquing. In any case, so engagement is expected at
14 this point in time. Just to go back to our findings,
15 Allison, I would take the history back quite a bit
16 further. And you could really probably go back to the
17 1930s, but in the 1980s, the public pension funds felt
18 like they were being squeezed between certain activist
19 holders, particularly those that did greenmail, that
20 basically held up companies and got paid off
21 privately, and then corporations that decided to
22 defend themselves by entrenching management through
23 poison pills, through staggering election of directors
24 and other means, and that there needed to be a voice
25 for long-term investors to advocate for their asset

1 managers and through their own programs to engage
2 constructively with companies.
3 And increasingly that became focused on the
4 board of directors and trying to make sure that there
5 was good engagement with the board and an opportunity
6 for the investors really to understand the strength of
7 the board. I'll stop there.
8 MR. ROCK: Thank you, Ken.
9 Heather.
10 MS. CORZO: Thanks. Thank you, guys. Thank
11 you all for being here and for the opportunity to
12 speak to you today. My name is Heather Slavkin Corzo.
13 As Edward mentioned, I'm here on behalf of the AFL-
14 CIO. We represent 12 and a half million union members
15 with more than $7 trillion invested in the financial
16 markets in the form of retirement savings.
17 In addition to that, I am the Head of U.S.
18 Policy for the UN Principles for Responsible
19 Investment. We are the world's leading proponent of
20 responsible investment, with over 2,100 signatories
21 globally investing $82 trillion. Of that, around 400
22 of our signatories are in the U.S., with $45 trillion
23 in assets under management.
24 And, finally, I am a Senior Fellow at
25 Americans for Financial Reform, a coalition of more

1 than 2,000 civil rights, consumer, labor, business,
2 and other organizations formed in the wake of the
3 financial crisis to lay the foundation for a strong,
4 stable, and ethical financial system. Whoo, so I got
5 through that. You guys, if you think that took a
6 while, imagine what it's going to be like come tax
7 time.
8 But as for the topic of today's panel, we've
9 been asked to discuss what shareholder engagement and
10 corporate governance looks like today. The AFL-CIO
11 has a long history of engaging in corporate governance
12 initiatives. The initiatives that most people who
13 participate in the corporate governance space are most
14 familiar with are the engagements on behalf of the
15 AFL-CIO reserve fund, where we file dozens of
16 proposals every year on topics ranging from executive
17 compensation to human rights issues in the supply
18 chain to political spending disclosure. We change the
19 subjects periodically. And, you know, the engagement
20 goes back more than 20 years.
21 In addition to that, there is an AFL-CIO
22 equity index fund. It has about $8.4 billion in
23 assets under management, large for, you know, the
24 regular person, but compared to what Barbara's
25 managing, it's a pittance. And what the AFL-CIO

1 equity index fund does is we are a large cap equity
2 index fund. We file shareholder proposals
3 periodically, and there's AFL-CIO proxy voting
4 guidelines, and so all of the votes are cast in
5 adherence to the guidelines.
6 So when discussing engagement by large
7 institutional investors, I think it's important to
8 distinguish between the activities undertaken by large
9 money managers versus including those who manage
10 pension funds versus large pension funds that may
11 engage more directly in corporate governance matters
12 through the shareholder proposal process.
13 Large pension funds have managed to push the
14 agenda on specific issues to get a say on issues like
15 executive compensation, board diversity, proxy access,
16 et cetera. In the U.S. context, however, the large
17 money managers have not been as active in my
18 experience on direct shareholder proposals through the
19 SEC process.
20 As Barbara spoke about, the rise of
21 stewardship codes around the world, however, has led
22 to an increased focus on how large money managers
23 approach governance and expectations that large
24 institutional investors will show a commitment to
25 transparency and drive good corporate governance

1 practices through engagement and voting.
2 So the ability of investors to engage with
3 companies and the types of issues that may be raised
4 through formal proceedings is limited. The SEC has an
5 extensive body of regulation, guidance, staff legal
6 bulletins, and nonprecedential but informative, no-
7 action responses that guide investors on acceptable
8 topics for engagement on ESG issues through the proxy
9 process. At a very high level, the SEC will grant --
10 issues no-action requests to allow for the exclusion
11 of a shareholder proposal if it seeks to micromanage
12 the company or if it's considered ordinary business.
13 If a topic is considered a significant
14 social policy issue, the shareholder proponent may
15 nonetheless overcome a request for exclusion. There
16 may be investors who are engaging with companies
17 through informal means. That's not typically how the
18 AFL-CIO engages. So the subjects that we are engaging
19 in with companies are really limited to the ones that
20 the SEC has determined are acceptable topics.
21 These tend to be -- I'm hard-pressed to
22 think of an example that’s not an environmental,
23 social, or governance issue, or an ESG issue. I can't
24 think of a single instance where we’ve talked to a
25 company about product pricing.

1 And, in fact, as I think about it, it's hard
2 for me to imagine that it would even be legal. I
3 think one thing that we have to think about is the
4 reality that insider trading laws prohibit companies
5 from sharing material, nonpublic information, from any
6 -- with any investor. So it's interesting for me to
7 hear the topics that are under discussion, the
8 conversations around whether there may be some
9 anticompetitive impact that arises from investor
10 engagement on governance issues. It's hard for me to
11 imagine how it would actually happen. And I think to
12 the extent it was, it would already be illegal and
13 cause for serious concern.
14 So I think it's important to look at the
15 questions being raised today about whether investors'
16 engagement on corporate governance matters lead to
17 anticompetitive activities in the context of the
18 larger debate that's happening in Washington that is
19 really aimed at silencing investors when we attempt to
20 engage with companies on ESG issues.
21 There is a hearing under way as we speak in
22 the Senate Banking Committee right now to consider
23 proxy voting and proxy advisers. And the SEC has
24 taken a number of actions to scale back investors'
25 rights, to raise topics of concern with a company

1 through the shareholder proposal process, just in the
2 last few months.
3 This is actually the opposite of the
4 direction we should be headed. Individual investors
5 are increasingly concerned about the impact the
6 companies we own are having on the environment, income
7 inequality, and other ESG matters. That is why large
8 money managers are increasingly developing responsible
9 investment options, and we should be encouraging that
10 activity.
11 So I just -- I want to take one second to
12 respond. We've heard other panelists respond to this
13 notion that the way to respond to the concerns that
14 are being raised about potential anticompetitive
15 activity is to remove the rights of large
16 institutional investors to participate in proxy
17 voting. That is a serious concern to me. I think
18 that would remove a tremendous opportunity for
19 accountability.
20 And as Allison discussed, there is a --
21 there's a balance that exists right now in the
22 corporate governance system that provides
23 accountability along the line. It would be very
24 disruptive to interfere with that.
25 So with that, I'll conclude my comments and

1 thank you all for the opportunity to speak today.
2 MR. ROCK: Thank you, Heather.
3 Holly, you spend a lot of time in
4 boardrooms.
5 MS. GREGORY: Yes. Thank you. Thank you
6 for inviting me to share a corporate governance
7 lawyer’s perspective on the issues that you're talking
8 around common ownership. I cochair Sidley Austin’s
9 Corporate Governance Practice. It’s a global
10 practice. I advise corporate boards on the whole
11 range of corporate governance issues, including
12 engagement with institutional investors and
13 shareholders.
14 Now for the disclaimers. I have not advised
15 anyone on the common ownership subject matter of this
16 hearing. I have not been retained by anyone to
17 participate in this panel. And the views I express
18 are my own and not for attribution to Sidley Austin or
19 any of our clients.
20 I’m going to make four observations. First,
21 while the institutional investor influence on publicly
22 traded corporations has increased considerably in the
23 past 20 years, the subjects of this influence, as
24 evidenced by the topics on which they vote and the
25 topics on which they engage, and as Heather mentioned,

1 do not appear to extend to ordinary-course business
2 decisions.
3 Outside of their very limited decision
4 rights as shareholders, shareholders cannot dictate
5 the actions of the corporation's board or its
6 officers. Directors and officers are fiduciaries, and
7 as such they're required to make their own judgments
8 in managing the business and affairs of the
9 corporation.
10 Now, shareholder influence, which I
11 mentioned is fairly powerful, comes in large measure
12 from their ability under federal law and regulation to
13 bring nonbinding shareholder proposals and company
14 proxy materials, and also to have advisory vote on
15 executive compensation and on the golden parachute
16 compensation.
17 Companies face significant pressure to
18 address, say-on-pay issues where the management
19 proposal does not achieve a significant majority of
20 support, and also to implement majority-supported
21 shareholder proposals. And failure to do so can lead
22 proxy advisory firms to recommend against the
23 reelection of directors.
24 Now, ordinary business operations are not a
25 proper subject of shareholder proposals. Absent an

1 overreaching policy issue, generally what products to
2 offer, what prices to charge, what areas to compete in
3 are ordinary business operations and they're excluded
4 from shareholder proposals. And, similarly, in
5 engagement efforts, institutional investors focus on
6 the broader issues concerning shareholder rights,
7 board accountability and governance, executive
8 compensation structure, and corporate, social, and
9 environmental responsibility.
10 And according to the stewardship reports
11 from the large institutional investors and surveys of
12 corporate directors and members of management, the
13 most common topics for engagement in 2018 and 2017
14 were around board quality and composition and
15 accountability, climate-related risk, and board
16 oversight of sustainability issues, executive
17 compensation, including alignment of compensation with
18 company performance, and shareholder rights. And
19 there are more, but that's really it. They're not
20 about these ordinary business issues.
21 My second observation. Both institutional
22 investors and their proxy advisers heavily emphasize,
23 as reflected in their proxy voting policies, that
24 executive compensation should be aligned with company
25 performance and not with industry performance. The

1 voting policies of institutional investors provide
2 that misalignment between pay and company performance
3 is grounds for a negative say-on-pay vote, and in
4 certain circumstances, grounds for a negative vote on
5 the reelection of compensation committee members. And
6 that's pretty powerful stuff to a board of directors
7 in thinking about compensation structure.
8 Similarly, the proxy advisers both
9 incorporate relative performance evaluation into their
10 analysis and will issue negative vote recommendations,
11 for say on pay, if executive pay and company
12 performance are not aligned. Indeed, a misalignment
13 of pay and company performance relative to peers is
14 the most common reason for proxy advisers to recommend
15 a negative vote on compensation, and it is the most
16 common reason for a failed say-on-pay vote.
17 My third point. The topics on which
18 corporations and their institutional investors engage
19 is heavily influenced by legal concerns, including the
20 need to strictly comply with federal securities and
21 antitrust laws and regulations. Focused attention by
22 corporate counsel in line with written guidance on
23 engagement activity undermines the notion that
24 engagement is a means through which investors
25 encourage companies to soften their competition or

1 through which companies communicate confidential
2 information about their competitive plans.
3 It is common practice in my experience for
4 counsel to provide corporate directors and members of
5 the management team with strict instructions about the
6 rules of engagement, including parameters of topics
7 for engagement. In line with SEC staff guidance,
8 discussion topics are typically precleared with the
9 shareholder and company counsel, either participates
10 in the meeting or briefs the company's participants in
11 advance.
12 Through engagement policies and direct
13 instruction from counsel, participants are reminded
14 that they must not selectively disclose material
15 nonpublic information in violation of Reg FD. They're
16 reminded about tipping and insider trading liability
17 that could result from someone else misusing material
18 nonpublic information.
19 If engagement is encouraged during proxy
20 season, special care is given to abide by the proxy
21 solicitation rules, which only permit attempts to
22 influence shareholder votes based on what has been
23 disclosed in filed proxy-soliciting material.
24 Directors and officers are also reminded not
25 to discuss competitive information, customer-specific

1 information, or details about the company’s pricing or
2 production capacity.
3 My fourth point. Institutional investor
4 engagement with portfolio companies has contributed to
5 decisions by corporate boards to change corporate
6 governance practices and to provide greater
7 transparency into their decision-making. For example,
8 in response to a combination of engagement and
9 nonbinding shareholder proposals. A majority of S&P
10 500 boards now require annual election of all
11 directors, majority voting in the election of
12 directors, and shareholder access to the company's
13 proxy to nominate directors.
14 This influence has a multiplier effect as
15 other corporate boards take heed of these developments
16 as evolving best practices and reflection of broad
17 shareholder expectations. They are implementing these
18 kinds of changes without direct shareholder
19 engagement. The focus is now shifting to the social
20 responsibility and environmental issues and corporate
21 sustainability that Heather mentioned, and, so, we
22 expect to see changes and greater transparency there
23 as well.
24 In conclusion, if a decline in competition
25 in concentrated industries is, in fact, associated

1 with common ownership, and I understand that that is
2 also a point at issue, policymakers will face very
3 difficult tradeoffs, given consumer interests in
4 diversified investment vehicles for investment and
5 college savings, and the benefits institutional
6 engagement brings to corporate governance. Thank you.
7 MR. ROCK: Thank you, Holly.
8 We now turn to David Hirschmann from the
9 United States Chamber of Commerce. Is this an issue
10 in which the AFL-CIO and the Chamber of Commerce are
11 shoulder to shoulder on?
12 MR. HIRSCHMANN: Actually, a few years ago,
13 I testified at the Senate Judiciary, and that morning,
14 I lost my voice. And I had to explain to Senator
15 Leahy who was chairing the hearing that on this issue
16 the AFL-CIO could speak for us. That issue happened
17 to be the protection of intellectual property.
18 Unfortunately, for all of you, today I have
19 my voice, so you'll have to hear me actually agree
20 with Heather and Ken.
21 MS. CORZO: Well, I'll enjoy it.
22 MR. HIRSCHMAN: So thank you, Ed. And
23 thanks to Commissioner Phillips, Commissioner Jackson,
24 the FTC, and NYU for holding this important forum.
25 The Chamber represents 3 million businesses of

1 virtually every size and shape in this country, public
2 and private. And we tend to come at these issues from
3 the perspective of what will better enable capital
4 formation. And that’s where we’ve long encouraged
5 companies to engage more with their shareholders --
6 public companies -- and we’ve engaged and encouraged
7 our asset manager members to engage with companies as
8 well. And both have responded. In fact, certainly,
9 we participate in countless conferences and other
10 forums to discuss how shareholders should engage more
11 and how to do that constructively.
12 Where we have disagreed, when we have, is
13 on proposals that we view as giving one or another
14 group of investors more favorable rules of the road
15 in a way that makes it hard for boards to exercise
16 their fiduciary duty to all shareholders. This has,
17 for example, driven our concern about the lack of
18 proxy advisory firms, which I’ll talk a little more
19 about in a moment.
20 So while we don't always agree with the AFL-
21 CIO and CI, I think we begin from a -- and what
22 strikes me about this issue that the common premise
23 that constructive engagement is better is something
24 that I hear widespread agreement on today.
25 Shareholder engagement does not drive down

1 competition. In fact, it can encourage and sustain,
2 and it's important for healthy capital markets.
3 Engagement allows management to communicate with their
4 shareholder base as they implement strategies to
5 generate long-term growth.
6 Our most recent proxy survey showed, for
7 example, that 80 percent of companies report that they
8 engage year-round in a regular communication program
9 with their institutional investors. And I'd be the
10 first to say that we should get that number closer to
11 100 percent.
12 With that in mind, I'd like to make a couple
13 of points. First, the subject in which companies
14 engage with their institutional investors; some of the
15 concerns public companies have when it comes to the
16 current practices related to corporate governance; and
17 finally the role of proxy advisory firms.
18 First, how do investors engage?
19 Institutional investors often communicate directly
20 with the company, and companies reach out to their
21 investors, either through their investor relations
22 department, through management, through the board, in
23 a number of means. And we are fortunate to live in an
24 era where there is accelerating innovation and
25 transformation larger than we've seen since certainly

1 the Industrial Revolution.
2 Frankly, I can't recall meeting with a
3 single business leader who isn't laser-focused on how
4 to drive that change in a positive way for their
5 business. In fact, because we understand that
6 virtually every business model can be disrupted today,
7 the Chamber is actively focused on removing barriers
8 to innovation and growth. In that environment,
9 companies must be able to communicate their strategy
10 with all types of investors and stakeholders. This is
11 the kind of constructive engagement that is happening
12 more and more and that most investors are seeking.
13 Second, what are some of the concerns we
14 have with the way public companies -- that public
15 companies have with the current state of play. While
16 we think constructive investor engagement is
17 beneficial, there are ways in which a minority of some
18 special interest investors can use outdated rules to
19 promote their agendas at the expense of other
20 investors. For example, rules governing shareholder
21 proposals have allowed proposals dealing with
22 social/political matters to proliferate, even when
23 they fail to gain significant support.
24 We are pleased that the SEC is now looking
25 at zombie proposals and other areas where the proxy

1 rules might need to be modernized so all investors --
2 both retail and institutional -- have a level playing
3 field.
4 Third, the role of proxy advisory firms.
5 Proxy advisory firms, as many of us know, have a
6 demonstrated influence in the manner in which large
7 public companies -- a large number of public company
8 shares are voted. In some companies, it depends on
9 the shareholder base, but it ranges, according to most
10 research, between 50 and 30 percent. Way too much
11 time is spent today in boardrooms to try to anticipate
12 what ISS or Glass Lewis think and how that might
13 impact how they vote in the next proxy season.
14 In fact, many companies feel the need to
15 hire the ISS's consulting arm to help guide them on
16 the nontransparent and uneven way in which they apply
17 their corporate standards. To be clear, we are not
18 seeking to federalize or eliminate proxy advisory
19 firms. We simply have pointed out that they play an
20 important role and have supported sensible reforms
21 that will enable them to better serve all stakeholders
22 in the capital formation system.
23 Reforms in this area are long overdue, but
24 that's a topic best left to the SEC. My point in
25 raising this issue today is not to labor into the

1 merits or relative merits of proxy advisers but point
2 out that much of the academic research in this space
3 has failed to even consider the role of proxy advisers
4 and certainly has not considered how the solutions
5 identified might influence the world that proxy
6 advisers play.
7 Finally, I'd like to end with one final word
8 about how the potential -- about the potential impact
9 of limiting common ownership could have on capital
10 formation, which as I said, is agenda one for the
11 Chamber. Index investors play a key role in
12 generating economic growth and job creation in a way
13 that's good for companies, it's good for retail
14 investors, and it's good for retirees.
15 Being part of an index is an important tool
16 to drive liquidity for all companies but especially so
17 for smaller public companies. If the government
18 places undue restrictions on investments in public
19 companies, it would further discourage companies from
20 going public and staying public. We have seen a sharp
21 decline in the number of public companies over the
22 past two decades, and liquidity concerns for smaller
23 issuers is an important reason. While this is harmful
24 for companies in our capital markets, it's also
25 harmful for retail investors who might not be able to

1 participate in some of the fastest growing and most
2 dynamic companies.
3 So thank you for including me today. We
4 welcome the FTC taking an evidence-based look at
5 common ownership at this hearing and what I'm sure
6 will follow in discussions as an important
7 contribution to that. And I'd urge us all to continue
8 to challenge the science behind some of the things
9 that have been supported and to think about the
10 consequences of some of the solutions being identified
11 to date.
12 MR. ROCK: Thank you, David.
13 We now turn to Scott Hirst. I hope the
14 clicker has made it down. Scott and Lucien Bebchuk
15 have been working on trying to document how much
16 engagement there is between firms and shareholders.
17 Scott.
18 MR. HIRST: Thank you, Ed. And, so, this
19 work builds on work together with Lucian Bebchuk,
20 including a paper last year in *The Journal of Economic*
21 *Perspectives* with Alma Cohen, a work that's currently
22 available on SSRN, and ongoing work that looks in more
23 detail at the implications of our analysis for the
24 common ownership debate. And the focus of our work is
25 on the stewardship decisions of index fund managers.

1 So by stewardship, we mean how they monitor, vote, and
2 engage with their portfolio companies.
3 And our work aims to provide a systematic,
4 theoretical, empirical, and policy analysis of these
5 stewardship decisions of investment fund managers.
6 And we identify the promise of institutional investor
7 stewardship to combat the problem of agency costs
8 between corporate managers and their shareholders.
9 And, so, the increasing size of institutional
10 investors over time and the greater monitoring and
11 engagement that this allows is a positive development
12 that can combat these agency problems within
13 corporations.
14 And we show in our work that institutional
15 investor stewardship has this promise to increasing
16 corporate performance. So because of this, we argue
17 that public policy should seek to encourage and to
18 facilitate stewardship and engagement by institutions
19 and not to limit it.
20 So we turn now to the common ownership
21 literature. And, so, common ownership alarmists have
22 argued that regulators should pay attention not only
23 to the decisions of these managers of corporations but
24 also to the ownership of those corporations by
25 institutional investors and in particular whether

1 these shares are held across competitive companies.
2 But in our analysis, we show that the
3 understanding of how these institutional investors act
4 requires taking into account their own ownership
5 structure, which common ownership alarmists fail to
6 do. And, so, we turn to the missing mechanism, the
7 link between common ownership and anticompetitive
8 effects, and we make two points.
9 First of all, common ownership -- the
10 question of whether common ownership can have
11 anticompetitive effects because of the big three or
12 other investment managers might actively encourage
13 anticompetitive behavior. And on this, our work
14 provides a detailed, empirical account of the
15 stewardship activities of large investment managers,
16 and we show that such active intervention in business
17 strategy decisions by institutional investors is both
18 implausible and inconsistent with the empirical
19 evidence.
20 Second, on the question of the purported
21 link by -- through passive means, could institutional
22 investors have anticompetitive effects by inducing
23 investment managers to do nothing and, therefore,
24 tolerate anticompetitive behavior. And our ongoing
25 work suggests that this mechanism is also implausible

1 and unsupported by the empirical evidence.
2 In our paper, we make the point that the
3 claims of -- not only are the claims of common
4 ownership unwarranted, but paying regulatory attention
5 to common ownership isn't merely unnecessary, but it’s
6 also costly, and counterproductive. Because it's
7 corporate managers and not institutional investors
8 that play the key role in shaping strategic decisions
9 that determine competitiveness, it's these decisions
10 of corporate managers that should be the central focus
11 of regulatory attention and not the actions of
12 institutional investors.
13 And given the constraints on the attention
14 and the resources of regulators diverting attention to
15 institutional investors and away from the decisions of
16 corporate managers is counterproductive. The measures
17 that those highlighting common ownership have put
18 forward, intended to make the big three investment
19 managers and other large investment managers less
20 engaged and more passive.
21 And the very fact that we're having this
22 discussion about the possibility of anticompetitive
23 effects of engagement by institutional investors might
24 itself chill engagement by investment managers. And
25 while common ownership alarmists view these measures

1 positively, we argue that the effects on investment
2 stewardship would be counterproductive. We claim --
3 we make the point that modern corporations do not
4 suffer from too much shareholder intervention but
5 rather from too little, and that pushing investment
6 managers away from engaging would be a step backwards
7 and would exacerbate agency problems and, therefore,
8 harm, rather than benefit, the economy.
9 To conclude, the rise in investor engagement
10 is a positive development that contributes to a
11 reduction in agency problems and, therefore,
12 contributes to economic performance. The incentives
13 of investment managers make them insufficiently active
14 and excessively deferential to corporate managers.
15 And the measures that common ownership alarmists
16 advocate would be counterproductive in all of these
17 respects. Thank you, very much.
18 MR. ROCK: Thank you. Thank you Scott.
19 We're now going to turn to a discussion among the
20 panelists, but, please, if you have questions, please
21 fill out one of the question cards that will then be
22 brought up to pose to the panelists.
23 Also, especially for those who are watching
24 online or will watch online, the FTC welcomes written
25 submissions on these issues and finds them very

1 helpful in terms of filling out their understanding of
2 what’s going on in the corporate governance universe,
3 so please send in written submissions as well.
4 I want to drill down on this notion of
5 engagement. Engagement has -- there are at least
6 three different types of engagement that are
7 interestingly different. One is the engagement over
8 high-profile contests. So Trian runs a contest to
9 elect Nelson Peltz to the board of Procter & Gamble.
10 These are high-stakes contests with real potential
11 effect on firm value. There may be 10 to 20 of those
12 a year, and that's one sort of engagement.
13 We know that to a large degree in those
14 sorts of engagements, BlackRock, Vanguard, and State
15 Street, the big three, often collectively, though they
16 don't act together, collectively hold the decisive
17 votes. And we’ll often hear from folks who are
18 contemplating bringing proxy contests that you need to
19 win two of the three in order to prevail.
20 There’s a second sort of engagement, which I
21 think of as market-wide governance issues, things like
22 is it appropriate to have annual voting on directors,
23 or is a staggered board okay. Is it okay to have a
24 poison pill or not? Should there be majority voting?
25 That's a different sort of engagement; it’s

1 a different set of issues. And the third sort of --
2 but it's market-wide. The third sort of engagement is
3 on firm-specific performance, firm-specific pay. And
4 that’s yet a different sort of engagement, and I think
5 it's useful to think about these three categories of
6 engagement differently and address them separately.
7 What I’d like to now is turn to -- first to Barbara
8 and then to Holly and Heather to take us inside the
9 room, if you will, right?
10 When we’re talking about engagement, what
11 are we talking about? How many meetings a year does
12 BlackRock have with portfolio companies? They own
13 everything, and there are a lot of companies out
14 there, both here and abroad. How often, how often can
15 BlackRock meet with individual companies? Once a
16 year? Once every three years? Once every five years?
17 How does that differ with respect to high-profile
18 contests, like Procter & Gamble’s proxy contest,
19 versus the ordinary, day-to-day kind of engagement?
20 And, finally, what are the topics of these
21 different forms of engagement? How much -- Holly
22 pointed out the directors having instructions about
23 what they can talk about and what they can’t talk
24 about and encouraging directors to reach out to the
25 shareholders before meetings so that there’s an

1 agreed-upon set of issues.

2 So if you can take us into that world.

3 MS. NOVICK: Okay, so, first, let me make

4 very clear, BlackRock does not collude with any other

5 firms on our voting on any topics. That’s a very

6 important thing because the idea that there are a big

7 three and they all vote as one is a misnomer. When

8 you look at the data, in fact, our voting is quite

9 different from each other, and there is no concept of

10 aggregation because we don't compare notes beforehand.

11 Okay, so now, I want to share some both

12 numbers and some anecdotes I think will help in

13 explaining Ed's question. The first thing is we think

14 about engaging with companies on a few key areas. One

15 is we vote at lots of shareholder meetings. I’ll give

16 you some numbers on that. And sometimes we need to

17 clarify something that’s in the disclosure's simple

18 questions.

19 Second is there might be an event at the

20 company. I don't want to pick on Trian, but since you

21 brought them up, maybe they're doing something or some

22 other activist is doing something, and we want to

23 engage with all of the parties so that we can hear

24 everybody's story and understand how we want to vote

25 in the best interest of our clients as shareholders.

1 Another area is what I'll call thematic
2 governance. So what would be examples this year? We
3 announce our engagement priorities. In fact, we're
4 quite transparent. We put them on the web. We talk
5 about them in Larry's letter. We do lots of things to
6 make sure people know what issues are we concerned
7 about. One of the issues we identified was board
8 composition and diversity.
9 And I'm happy to say, when you look back at
10 the end of the proxy season this year, there was a
11 noticeable increase of women on boards. It actually
12 moved two percentage points in the last year. Now,
13 for the women in the room, hurrah, right? I mean,
14 we've been talking about this forever, but you barely
15 see the needle move year after year after year.
16 Now, the more we focus on it, the more we
17 talk about it, we find boards do say let me think
18 about that, let me really rethink how I'm approaching
19 the next search.
20 Other more industry-specific topics. Things
21 like opioids. So there's a whole chain of what goes
22 on from manufacturing to distribution. We want to
23 understand how companies in that business are managing
24 their risks, are enforcing current laws, and are
25 making sure that we are protecting the value of the

1 companies, again, that we engage in on behalf of our
2 clients.
3 How often do we meet with individual
4 companies? It very much depends on are there any of
5 those issues on the table. We also meet with
6 companies when they request a meeting. And,
7 generally, we encourage that off-season, so not during
8 the proxy season, but just to get to know management
9 better, to get to understand the company better.
10 I mentioned in my prepared remarks, it's
11 never about product pricing. It's about the board.
12 It's about governance. It's about risk management.
13 It's about much higher level things. In the 2018
14 proxy season, to put some numbers on it, we had 2,049
15 company engagements. We voted in 17,151 meetings. We
16 voted on 158,942 proposals, and that included voting
17 in 89 countries.
18 Now, where would I get stats from that?
19 Once a year --
20 MR. ROCK: How big is your engagement group?
21 MS. NOVICK: We have 40 people. Once a
22 year, we publish an annual report where we detail what
23 were engagement priorities and topics, give examples
24 of engagements that actually occurred, talk about the
25 voting statistics and things like this, how much do we

1 vote. That's the engagement part.
2 In the U.S. alone, there were 3,904 meetings
3 with 31,265 proposals. So you kind of get a sense of
4 the magnitude. Are we going to have the resources to
5 do some deep dive and try and manage a company? No,
6 and it's not legal, as you've heard from the other
7 panelists.
8 So let me just refer back to some of what
9 Rob Jackson said -- Commissioner Jackson -- and other
10 people about disclosure. If you read the editorial,
11 the op-ed that was submitted by Jack Bogle, both of
12 them have a commonality. They go through and they
13 talk about the different potential remedies, and they
14 actually reject all of them except disclosure. Why?
15 Because disclosure, sunshine, it's a good thing; it is
16 self-correcting.
17 We already do all of this. We publish the
18 engagement priorities, we publish the voting
19 guidelines, we publish the actual voting, we put out
20 quarterly reports by region, we put out an annual
21 report that is global. We are incredibly transparent,
22 and, frankly, we encourage a raising of the bar
23 industry-wide to have similar transparency from all
24 managers.
25 MR. ROCK: Holly, take us into the

1 boardroom.

2 MS. GREGORY: Yes, indeed. Look, I think

3 there are all kinds of different situations that give

4 rise to engagement, but engagement often, at least in

5 large S&P 500 companies, has started to follow sort of

6 a pattern throughout the year. Immediately after the

7 annual meeting, the company, the board, the company

8 management, are trying to understand how shareholders

9 voted.

10 And there will be, in the fall usually, some

11 outreach to large institutional investors. Some of

12 it's through surveys -- written surveys -- to get to a

13 bigger group of shareholders, but also through

14 meetings to find out what's on their minds, what was

15 on their minds when they voted, what drove some of the

16 votes, if there were any problematic votes, and, also,

17 what do they think the big issues are going to be in

18 the proxy season going forward, just to start to get a

19 temperature so that helps the board sort of get ahead

20 of the game if there are kinds of corporate governance

21 issues that they think they should be looking at.

22 I want to -- and then as you get into proxy

23 season, it changes. It depends on the kinds of

24 shareholder proposals you're getting, the kinds of

25 pressure for engagement that may be coming from

1 investors, but really it's important to understand
2 that engagement happens in really two directions. And
3 often we're counseling boards and management members
4 to be in listening mode when they meet with their
5 investors, to really use it as an opportunity to hear
6 what's on their minds. And in other situations, the
7 company has a viewpoint that they want to help get
8 across and emphasize.
9 I do think a real positive development
10 in engagement efforts generally is that it's becoming
11 far more common for an independent director to
12 participate. Investors often ask for an independent
13 director to participate, and because they want to
14 get that sense of how engaged is the board, how
15 knowledgeable is the board around some of the kinds of
16 issues that are on their mind.
17 There are a couple things that including
18 that independent director do. Certainly, it helps in
19 that discussion with the shareholder to let them know
20 how engaged the board is. But it really adds a level
21 of rigor into the company's preparation for those
22 discussions, including rigor around the kinds of legal
23 issues, what will be the topics discussed, and the
24 level of preparation.
25 And I also think --

1 MR. ROCK: Can I follow up on that just for
2 a second?
3 MS. GREGORY: Sure.
4 MR. ROCK: In preparing directors and
5 managers for those meetings, does the issue of talking
6 about future pricing strategy come up?
7 MS. GREGORY: We have a standard memo that
8 we provide to teams that are going to go into
9 engagement that talks about antitrust concerns,
10 absolutely. So it's definitely there in the kind of
11 counsel, the legal counsel at least in my experience
12 are giving, and that's based on what I do.
13 Having an independent director, though, in
14 addition to enhancing the rigor and being a real way
15 for the shareholder to get a sense of how involved the
16 board is, it also means that the board now has a real
17 window into the engagement, and so it adds a level of
18 scrutiny that I think is also very helpful. Boards
19 are very interested in those engagement efforts, and
20 when a comp committee chair or a lead director, chair
21 of a non-gov committee, chair of an audit committee,
22 goes in to an engagement meeting, the expectation is
23 that they're going to report out on that discussion to
24 the board.
25 MR. ROCK: And, Heather, when you're meeting

1 with issuers, with companies about various shareholder
2 proposals that the AFL-CIO is presenting, tell us
3 about -- tell us about those meetings.
4 MS. CORZO: So as you suggested, typically
5 when we're having meetings with issuers, they come
6 about because we filed a shareholder proposal at the
7 company and they're reaching out to us then to have a
8 conversation about it. And, you know, the nature of
9 the conversation depends on, on what the issue is. We
10 would -- I can't say never. We would never talk about
11 product pricing, but typically, the topic of the
12 conversation is within the scope of the shareholder
13 proposal that we have submitted that's limited as a
14 result of the SEC regulations that limit the subject
15 matter of the proposals we're permitted to submit.
16 Now, the conversation that happens depends
17 on where the company stands with regard to the
18 proposal. So sometimes the company will come to us
19 and say, you know, you raised this issue with us about
20 our political spending disclosure, and it was
21 something that we hadn't really thought that much
22 about until you filed the proposal, and thank you for
23 doing that. We're going to do X, Y, and Z in response
24 to the proposal. If we do this, will you withdraw the
25 proposal, and we'll negotiate. And oftentimes we end

1 up withdrawing the proposal in response to the
2 interaction.
3 You know, sometimes the company will come to
4 us and say we think you got it wrong, we think your
5 analysis is incorrect. You know, the justification
6 for this proposal is not based on, is based on an
7 understanding that differs from our understanding.
8 And, so, then we have a conversation again confined to
9 the bounds of the subject matter that we raised with
10 the company through the shareholder proposal process.
11 And then, of course, sometimes we don't have
12 a conversation with the company and we receive no
13 action letter from the SEC, and then there’s a very
14 time-consuming process that involves our on-staff
15 attorneys, you know, responding to the submission the
16 company has filed with the Securities and Exchange
17 Commission asking for permission to exclude our
18 proposal. It could be on any number of grounds, and
19 we go back and forth and ultimately get a
20 determination from the Securities and Exchange
21 Commission as to whether they're granting the
22 company’s no-action request and then know whether our
23 proposal will go to a vote at the annual meeting.
24 We have an open-door policy, so we’ve had a
25 number of meetings similar to what Holly suggested

1 that are not -- you know, inside the shareholder
2 proposal schedule. And we have conversations, but,
3 again, it's very clear when we're engaging with these
4 companies we have a handful of proposals that we file
5 each year. It's broadly recognized what the subjects
6 are that we're going to be discussing, the issues that
7 we care about, and we stick to the boundaries of those
8 topics.
9 MS. BENNINGTON: Do you mind if I just jump
10 in her for a sec?
11 MR. ROCK: Please.
12 MS. BENNINGTON: So when I was preparing for
13 this panel today, I thought a lot about what is it
14 that these interactions can be and sort of from the
15 top level like Barbara mentioned, board composition,
16 issues of engagement that Heather was talking about.
17 And I looked and looked, and I found the most detailed
18 type of engagement questions I could possibly find.
19 And, actually, I will read those to you.
20 I've never seen anything this detailed, so
21 I'm going to read it to you as far detailed as I think
22 it goes. And this is from SASB, which is the
23 Sustainability Accounting Standards Board. And what
24 SASB does is they divide into 79 sectors, so very
25 specific into sectors. And what they do is they

1 provide a set of guidelines for owners if they want to
2 think about risk management and consider questions to
3 potentially ask managers -- corporate managers -- in
4 connection. And, so I'm going to read this to you
5 because I think it maybe provides kind of the -- I
6 don't know if it's the ceiling or the floor. It's one
7 or the other.
8 Okay, so for the wireless telecommunications
9 industry, which I've tried to find the most
10 concentrated industry I could find, which is my
11 understanding is the top four are 93 percent of the
12 market. Okay, so I'm going to read you a couple of
13 the things SASB says, maybe things that owners want to
14 engage with managers to understand corporate risk.
15 Okay. What internal processes does the
16 company employ to protect and defend against cyber
17 attacks? How does the company identify and address
18 data security risks across its product lines? What is
19 the level of capital investment the company has made
20 into improving the reliability and quality of the
21 service network? How does the company manage
22 leveraging customer personal data for revenue
23 opportunities with maintaining customer privacy?
24 So those are some of the most detailed
25 business-orientated sort of questions or potential

1 engagement I’ve seen. And I just point out that what
2 are those topics and what are they not? So that's
3 just a little bit of food for thought, and people
4 might want to take a look at the SASB guides.
5 MR. ROCK: So let me follow up on that with
6 a question from the audience, which I’ll interpret
7 slightly to bring within this. So, Barbara, you were
8 very proud of the effect that your initiatives on
9 gender diversity on the board had. And Larry Fink has
10 talked in his letter about ESG initiatives. You’ve
11 talked about guns, policies and so forth, where you’ve
12 brought about real change in companies.
13 The question is how is it possible to
14 promote those goals but not also -- and here, I'm
15 interpreting, but now it also has the power to promote
16 anticompetitive goals. So is the reason that you
17 think BlackRock doesn't promote anticompetitive goals
18 is you don't have the power, maybe because to do so
19 you would have to drill down much more specifically
20 than the kind of level of questions that Allison was
21 pointing out? Is it because you don’t view it in your
22 interest? Where does the -- the question is being
23 asked is if you can succeed in bringing about change
24 in gender diversity, then why can’t you succeed in
25 forcing companies to adopt a soft competition

1 approach.

2 MS. NOVICK: So the first thing is keep in
3 mind we have -- let's call it 5 percent ownership. So
4 even on gender diversity, if we were the only voice
5 out there saying that we thought diversity of thought,
6 diversity on various dimensions was important, it
7 would fall on deaf ears. No one would care. But when
8 there is a chorus of voices across the spectrum of
9 different asset owners, it then resonates with a
10 company, gee, this is something important I should be
11 thinking about.

12 If you look over the long term, the ideas of
13 overboarding, the ideas of active CEOs sitting on
14 multiple outside boards, all of these governance
15 issues have shifted over very long periods of time
16 because more owners have spoken up. We heard about
17 the PRI today, we heard about the SASB. You know,
18 there are many different groups that are weighing in
19 on corporate governance issues. None of them are
20 weighing in on competition issues. I mean, it's as
21 simple as that.

22 If we somehow in some weird scenario decided
23 to ignore all antitrust and competition law, which
24 we're not going to do, we would be the only one
25 because everybody is subject to certain rules. So the

1 idea that any one actor can have that influence, if
2 anything, and I think we've heard this today, the sole
3 actor that has the most influence is the proxy
4 advisory firms, right? Fifteen to 25 percent, on say
5 on pay. So if you're a public company and you're
6 concerned about a vote coming, the first place you
7 look is those firms because they influence such a high
8 percentage of the voting individually. And that's the
9 part that's completely missing from any of the common
10 ownership analytics they just completely ignored.
11 MR. ROCK: Holly, I want to turn a question
12 to you. Let's take this scenario in which -- the so-
13 called conflictual scenario that was mentioned this
14 morning. That is to say a proposal that one firm in
15 the oligopoly should take a hit because it's better
16 that it loses sales because it benefits this purported
17 common owners' portfolio-wide interest.
18 And I'm now thinking, in the boardroom, the
19 question -- one of the questions from the audience was
20 do interventions by activist investors -- Carl Icahn,
21 et cetera -- impose sufficient market discipline where
22 management is lagging to prevent anticompetitive
23 behavior. Tell us a little bit about what I now hear
24 from lots of people, which is this notion of thinking
25 like an activist before the activist shows up and how

1 that is shaping boardroom discussion.
2 MS. GREGORY: Well, look, there is clearly
3 great interest in boardrooms across America in how
4 activist investors think for a couple of purposes.
5 One, to think about how to be prepared to defend
6 against an activist incursion, but also because
7 there’s a sense of it’s a way to challenge the
8 management team to really think about opportunities
9 that they might otherwise miss. So it provides a -- I
10 could argue a healthy disciplining to know that that
11 group is out there.
12 I think when boards are thinking about those
13 activists, they’re trying to think about what -- what
14 their weaknesses are from a corporate governance
15 perspective that could be attacked. What kinds of
16 strategies an activist might come forward to and
17 recommend, and are those legitimate strategies and
18 things that should be undertaken.
19 But I don't think that their strategies,
20 again around the anticompetitive kinds of issues that
21 the common ownership debate is concerned with -- they
22 tend to be kind of bigger picture. Sometimes they're
23 structural. I don't know if I’m getting to your
24 question, but that’s my experience with how boards
25 really look at those issues and the kind of influence

1 that activists have when they're not yet at the gates.
2 MR. ROCK: Barbara.
3 MS. NOVICK: So I wanted to just add one
4 little thing here. We heard earlier that, you know,
5 somehow activists are cultivating the index voter's
6 vote. So, again, stats are helpful. In 2017-18, the
7 proxy year in the U.S., there were 19 contests that
8 had dissident nominees to the board. To put in
9 perspective, we voted in favor about 20 percent, and
10 we voted against 80 percent.
11 Now, if you look again at the other firms --
12 I don't have the data here -- but I think what you'll
13 find is they voted differently, contest by contest,
14 because stewardship and engagement is about hearing
15 the perspectives of all the people who are putting up
16 a slate and making a decision in your best judgment as
17 a fiduciary what do you think is in the best long-term
18 interest of these shareholders. So it's not voting
19 all one way or all another way or voting collectively.
20 It just doesn't exist.
21 MR. ROCK: Let me move on to another topic,
22 which is there are different ways in which investors
23 communicate with firms. We've been talking about
24 these engagement meetings, but another way in which
25 investors and others communicate with firms is

1 earnings calls. And often quarterly managers --
2 typically the CEO, CFO, occasionally a director --
3 will get on a conference call with whoever wants to be
4 on it. And it will typically be shareholders and
5 others who follow the company.
6 That would be another potential channel by
7 which -- it's a potential channel by which
8 shareholders can influence company strategy. Is it
9 the same people who are on these calls as are doing
10 the stewardship? Are they different people? Are
11 these different kinds of relationships? Let's talk
12 now a bit about the earnings call.
13 Holly, you deal with folks who are having to
14 go on these earnings calls, and then I'll turn to
15 others on the panel who want to jump in.
16 MS. GREGORY: The same kind of preparation
17 goes into earnings calls. Directors tend to be a
18 little less engaged in that, but there's a lot of
19 preparation and there's a clear understanding around
20 the team of the rules of the game. But the thing
21 about earning calls that's so interesting to me is
22 they're public. So if something happens on an earning
23 call, the regulators have every ability in the world
24 to be scrutinizing that and taking action.
25 So I don't see earning calls as the issue,

1 if you will. Now, I can't promise that analysts don't
2 ever say things that are probably not appropriate
3 topics for earnings calls, but I don't know that
4 that's actionable either. I think it would be
5 interesting to know what kind of guidance analysts get
6 when they go on earning calls, and that would be
7 interesting to hear from the investor perspective.
8 MR. ROCK: Barbara, who from BlackRock is on
9 the earnings calls?
10 MS. NOVICK: So you have to look at our
11 business, and every asset manager's going to have a
12 different mix. In our business, our equities are 90
13 percent index and 10 percent active. So in the index,
14 it would be probably no one's on the earnings call, or
15 if they are, they're in listen-only mode because
16 they're curious to learn more about the company, and
17 that would be the stewardship team, and that's where
18 I'm involved.
19 On the 10 percent that is active, it would
20 be a portfolio manager or an equity research person
21 who has a much stronger interest in that company. But
22 as you heard, those calls are public. I think people
23 have a pretty good idea what the rules of the road are
24 and would not stray into that territory.
25 MR. ROCK: And when they're --

1 MR. BERTSCH: Ed, can I just add? I've been
2 in a lot of not public/private conversations with
3 portfolio managers and analysts, with management and
4 sometimes directors. And in all the conversations
5 that I've had, I can think of only two where there
6 were inappropriate comments from a regulatory
7 standpoint, both really FD. One actually involved
8 antitrust, but it was antitrust strategy, and one of
9 our analysts trying to push the company to disclose
10 privately what wasn't private. And in that case, the
11 company said we can't talk about that.
12 In the other case, a director started to
13 talk about the next quarter and what he expected for
14 the earnings. Totally inappropriate. We stopped that
15 conversation because we were going to have to have a
16 trading freeze.
17 So you've got two parties, and they're both
18 sort of steeped in the rules, and there are slips
19 occasionally, but I think in my experience one or the
20 other will stop that conversation.
21 MR. ROCK: And in terms of -- so you have
22 analysts -- you have portfolio managers who know a lot
23 about the company because they -- they're picking and
24 choosing stocks. They have to decide whether to sell,
25 to hold, to buy more. You've got proxy stewardship

1 groups that have this broad -- this broad
2 responsibility to make sure that you vote on all the
3 things you have to vote on. Tell us a little bit
4 about the intersection and the interaction between
5 those two groups and how that informs the work that
6 the proxy voting group does.
7 MS. NOVICK: So in many cases, we have
8 holdings that are only in an index portfolio and
9 figure we manage against so many different industries,
10 we have sort of every company in some way in an index
11 portfolio. And the percentage is based on which
12 indices do clients choose to put their money in.
13 Where there is a overlap with an active
14 holding, we encourage the stewardship analyst and the
15 active equity analyst to have a conversation to
16 compare notes. We actually allow, at BlackRock, that
17 there can be a split vote. So when you look at our
18 actual voting, you will find cases where we did not
19 vote a hundred percent of the shares the same way.
20 And that's a conscious decision we've made that an
21 active portfolio may have a different perspective, and
22 while they compared notes beforehand, they may have
23 different reasons.
24 I'll give one easy example. Let's say an
25 active portfolio manager just established a position

1 at a company. It would seem that they’re confident,
2 they're coming in at a good price, they’re confident
3 in that management going forward. But let’s say the
4 stewardship team has engaged over time and feels that
5 some things haven't been done that they want to see
6 done.
7 So the stewardship team may say, you know,
8 it's time. You know, we have patience, but patience
9 is up, it's time for us to vote against some specific
10 director, call it the audit committee, the
11 compensation -- whatever. Whereas the active manager
12 who just bought that company, just entered, might say,
13 well, I entered on the premise that I understand
14 what’s going on and I think there’s going to be change
15 over time, and I'm okay being patient now. So you see
16 those kinds of splits, and there can be splits on
17 other things.
18 But it is an open dialogue internally and
19 then an independent decision for the vote itself.
20 MR. ROCK: Do others on the panel want to
21 jump in on this before I move on to a related topic?
22 Go ahead, David.
23 MR. HIRSCHMANN: I think -- two points
24 quickly. One is from our experience asset managers
25 and investors take their fiduciary responsibility to

1 represent the underlying interests they represent
2 pretty seriously, and I think you heard that today
3 from Barbara. And management takes its fiduciary
4 responsibility to shareholders pretty seriously.
5 We can't lose sight of the fact, though,
6 that the way to influence corporate behavior goes well
7 beyond that relationship to the court of public
8 opinion in a way that consumers are increasingly
9 participating in, employees, investors, right, and
10 it's that -- we have to be careful not to confuse both
11 of those.
12 Now, companies respond to both. They care a
13 lot about their reputation, but that doesn't mean
14 every debate belongs on the proxy.
15 MR. BERTSCH: One other miss here, thinking
16 of Barbara's comments on split votes and so on, many
17 of our members retain vote authority, so BlackRock may
18 be managing their money, but BlackRock's not voting
19 their shares, and I don't think that's reflected in
20 some of the literature.
21 MS. NOVICK: We estimate 25 percent of our
22 equity separate accounts clients retain the votes, so
23 large public plans who have their own stewardship
24 teams. And, so, whereas we have to report the voting
25 under the various forms -- 13(f) is the one that's

1 applicable to these studies.
2 MR. ROCK: Because you have investment
3 authority.
4 MS. NOVICK: Because we have investment
5 authority, we’re required to report these as, you
6 know, shares that we have investment authority over,
7 but a huge percentage of them we actually don't vote.
8 There’s a slug that is voted by the clients
9 themselves. There’s another whole slug that we have
10 to outsource for regulatory reasons or conflict
11 reasons.
12 And, so, you’ve got a data set on what
13 theoretically is voting data that doesn't actually
14 reflect the manager’s voting authority.
15 MR. ROCK: If you look at the antitrust
16 enforcer’s approach historically to both common
17 ownership and cross ownership, the threshold is much
18 higher than we're talking about here. This is much
19 lower level. But in addition, one of the factors that
20 the antitrust enforcers look at is whether you --
21 whether the investor has or the cross owner or common
22 owner has board representation.
23 And this brings me to one of the questions
24 from the audience. Section 8 of the Clayton Act bars
25 interlocking directorates. Does the panel accept the

1 antitrust concerns underlying this law? If not, why?
2 If yes, would these concerns extend beyond -- as the
3 question puts it -- formal board membership? But what
4 I would -- I interpret that as saying to the extent
5 that there are large shareholders who have influence,
6 should the same antitrust -- and I think this is a
7 fair interpretation of the question, should the same
8 antitrust concerns that motivate Section 8 of the
9 Clayton Act and the bar on interlocking directorates
10 also bar common ownership.
11 MS. GREGORY: So my answer is no. I didn't
12 give the lawyerly "it depends." It's a different
13 nature of control and influence. A board has control.
14 A board has fiduciary obligations. And, so, you want
15 to make sure that the boards of competitors are indeed
16 separate groups of people for the most part.
17 The influence that we're talking about
18 investors is -- it's an important influence. I think
19 it's brought great benefits, but it's not the same.
20 It's not control. Even when it's strong influence,
21 there are all of the -- there are other investors who
22 have -- who are trying to exert influence in great --
23 in different ways. The amount of ownership by any
24 individual investor in a company is still not nearly
25 at the levels that we consider to be problematic. So

1 I just think -- I think it's apples and oranges.
2 MR. ROCK: Heather, does the AFL-CIO
3 nominate directors?
4 MS. CORZO: No. You know, there have been a
5 couple of times I can think of -- I've been with the
6 AFL-CIO for almost 12 years. There have been a couple
7 of times where we have supported "vote no" campaigns,
8 but I can't think of any examples where we've actually
9 nominated. It's a very onerous and expensive process.
10 And, so, I don't think even the threat of that or the
11 ability to do that would create the implication of
12 some sort of control, you know, or influence over the
13 firm.
14 And, you know, I agree with Holly.
15 Investors -- we talk about ourselves as owners of a
16 firm, but I think that really does overstate the level
17 of control we have over the operations. A director is
18 extremely different in the terms of the ability to
19 influence decision-making within a company.
20 MS. GREGORY: Can I say something along
21 those lines?
22 MR. ROCK: Sure.
23 MS. GREGORY: So I know in the economic
24 literature and also in the legal literature there's a
25 lot of discussion about principals and agents and

1 about the shareholders being the principal and the
2 directors being an agent. It's an interesting
3 construct, but from a legal perspective, it's not a
4 true construct. So a principal can direct the
5 activities of its agent. Shareholders cannot direct
6 the activities of the board because the board is
7 charged with managing and directing the affairs of the
8 corporation under state law, and that's a power of the
9 board that doesn't belong to the shareholders, even if
10 all the shareholders come together as one. They can
11 vote out the board, but the board is a separate entity
12 and has that obligation.
13 MS. NOVICK: So if I could also jump in. So
14 this idea of nominating directors, I'll go even
15 further then that. The traditional asset managers, so
16 I'm talking long only, whether it's active or it's
17 indexed, and there could be some exceptions, but the
18 traditional asset manager does not nominate directors
19 and does not put shareholder proposals even on a
20 ballot.
21 So the AFL-CIO is taking a very active
22 decision to be active in shareholder proposals, but
23 most of the managers don't even put a proposal on,
24 never mind, you know, get into a proxy fight on
25 directors. We've never done either of those.

1 MR. ROCK: Ken? Your members, do you sense
2 from your members any desire to nominate candidates?
3 MR. BERTSCH: Well, so members have won the
4 proxy access tool and I expect it will be used
5 sometime in the next few years. It's a very difficult
6 tool. And it's -- you know, I think realistically
7 it's the hedge fund activist or the activist holders
8 who are running real contests that are holding
9 management accountable and hopefully getting noticed
10 by other boards who want to be competitive and stay on
11 the top of their game so that they're not targeted by
12 those activists.
13 So, yes, there is some interest, but it's
14 really for the extraordinary situation. It will be
15 used in some situation where a company has extended
16 poor performance, where it has ignored its
17 shareholders repeatedly. And Holly is right, the
18 board manages the company, but a poorly performing
19 company that doesn't listen ever to shareholders, I
20 mean, that's kind of a tenuous position. And it's
21 probably going to be a company that actually an
22 activist -- a hedge fund activist is going to have
23 some questions whether they can make money in the
24 company or not, but the pension funds have run out of
25 patience, and -- but it’s going to take a lot of work.

1 MS. BENNINGTON: I'd just jump in there for
2 one second. I talk about accountability, and just to
3 be really clear what that is, really what it means is
4 you can fire the board by not voting for them, but
5 that's really it. I mean, that is the ultimate tool
6 you have as a shareholder is you fire the board.
7 MR. BERTSCH: And it's not easy to do that.
8 MS. BENNINGTON: And it's really, really
9 hard. Something that I have seen, though, in the
10 corporate governance work that I do is the desire for
11 -- particularly on issues around policy issues and
12 diversity on the board, different thinking,
13 shareholders having the desire to potentially offer up
14 some ideas to the nominating governance committee on
15 people who might be good, but these are not proxy
16 fights. These are well-intentioned shareholders who
17 think that they may know somebody who might be
18 somebody that the company might want to consider. But
19 that's about as far as I've ever seen it go for asset
20 owners and asset managers that are not literally
21 activist investors who do run proxy fights.
22 MR. BERTSCH: Yeah, and I think most of them
23 actually don't even want to suggest names.
24 MS. BENNINGTON: Yeah, a lot of them don't.
25 MR. ROCK: Much less put one of their

1 employees on board.

2 Scott, a question from the audience. Scott

3 says that the common ownership debate itself may have

4 a chilling effect on engagement and increase deference

5 to managers. Does he or others on the panel have

6 thoughts on the remedies proposed by the common

7 ownership proponents?

8 MR. HIRST: I mean, I think that point is

9 that the fear of these remedies and the fear of

10 increasing regulation of the clients being proposed is

11 going to limit the extent to which managers -- sorry,

12 investment managers might engage.

13 You know, what kind of remedies do we think

14 would be appropriate? We think that the remedies that

15 are being put forward to -- that would have the effect

16 of limiting engagement are misguided and that none of

17 those are appropriate because the problem doesn't

18 exist because of the incentives of the investment

19 managers don't lead them to take this anticompetitive

20 behavior. So I don't -- we don't believe that there’s

21 a need for a remedy because the incentives of the

22 investment managers aren’t such that created this

23 problem.

24 MR. BERTSCH: Yeah, so we -- our members

25 don't want to take away the proxy vote from the large

1 index investors. We believe it's -- that’s the
2 opposite of the direction that we’ve tried to push in
3 for the last 30-plus years. So that's not -- in our
4 mind would be a very damaging solution. The idea of
5 essentially banning the largest indexes from doing
6 index investing, which is what -- when you’re saying
7 invest in one company per industry, that is not
8 indexing. That is some kind of active strategy, and I
9 don't even understand how it would work.
10 With the government assigning who can be in
11 which company and even defining the industries is
12 actually a huge problem anyway. I think that what
13 that means is breaking up BlackRock, State Street, and
14 Vanguard. And I think it’s going to lead to chaos,
15 more costs. You know, there may be legitimate
16 antitrust concerns at some point, but the case really
17 has to be made that it's worth the cost and
18 disruption. It would be expensive for our members.
19 MS. CORZO: I just want to weigh in to
20 associate myself with the issues that Scott and Ken
21 have raised about concerns with the policy proposals
22 that are put forward and, in fact, say -- repeat what
23 I said earlier, that I think it's extremely important,
24 in fact, that large institutional investors get more
25 engaged on ESG issues as opposed to less.

1 And to the extent we're looking for positive
2 ways, I think the best way to do that is to make it
3 easier for analysts to access more information about
4 environmental, social, and governance issues of the
5 companies that we’re investing in by improving those
6 disclosures.
7 MR. ROCK: Did you want to jump in on that?
8 MS. NOVICK: So I would say to date this has
9 not chilled our enthusiasm for engagement or voting.
10 There are laws on the books that -- again, not just
11 encourage us but actually require us to vote, and we
12 think informed voting, which requires engagement, is a
13 sensible way to do it.
14 Now, that said, if the laws change, the SEC
15 or the FTC changes the law, we’ll reevaluate and
16 follow the new laws. I will say that while a lot of
17 time is spent on the remedies, we have some
18 fundamental questions about the underlying models and
19 econometrics. I think as people get a chance to test
20 these models -- they’ve only been made publicly
21 available quite recently -- I think they will see that
22 this is much ado about nothing and, in fact, we don't
23 need these remedies because there isn't a problem.
24 MR. BERTSCH: Can I just add, so BlackRock
25 is very active and it has really taken a leadership

1 position. There are pretty large folks who are on the
2 fence and are not out there as much as some of our
3 members would like them to be. And I would point in
4 particular to some larger quant firms that are
5 inhibited by both the SEC and FTC regulation. And it
6 just is too much hassle, just -- so let's just back
7 off.
8 MR. ROCK: On the fence about what, about
9 getting involved --
10 MR. BERTSCH: About engaging.
11 MR. ROCK: In engaging.
12 MR. BERTSCH: I mean, everybody votes.
13 Everybody votes, you have to vote, but some people
14 vote down the line with ISS, which David doesn't like.
15 You know, some people are just checking the box and
16 not doing the job.
17 MR. ROCK: Let me follow up on that because
18 the universe of asset managers is heterogeneous. And
19 for -- let's take, just as an example, a high-
20 frequency trading house that has a huge position for
21 maybe a minute or so, and it happens that one of those
22 minutes falls on the record date, so they have to
23 vote.
24 MR. BERTSCH: Yeah, I wouldn't expect --
25 MR. ROCK: What sort of engagement, if any,

1 do you want from that shareholder?
2 MR. BERTSCH: Yeah, I don't want engagement
3 from frequently traded, and they don't want to do it,
4 so that's fine. I'm really talking about other kinds
5 of firms that are not high-frequency traders that --
6 particularly that use quant models and so they don’t
7 have the analysts to really understand.
8 MR. ROCK: What kind of engagement do you
9 want from them?
10 MR. BERTSCH: So, actually, ideally, some
11 thoughtful proxy voting, that they actually do the
12 job. And I recognize there’s a scale problem here,
13 but many of them are quite large and I think could do
14 a more careful job around that and occasionally
15 communicate with companies where they see something
16 that they're concerned about.
17 MR. ROCK: Holly?
18 MS. GREGORY: So it's an interesting theory
19 of how the world should work, but every investor, as
20 you note, they're not monolithic, and they have their
21 own strategies on how to best extract value and where
22 to spend their resources. I'm concerned that too much
23 pressure on investors to thoughtfully vote leads them
24 to higher proxy advisers and vote as proxy advisers
25 tell them to and say that that's our thoughtful

1 voting.

2 So I just think it's a little bit misguided
3 to sort of insist that everybody engage because
4 engagement is expensive. Companies are struggling to
5 find the time for engagement. They can't engage with
6 every shareholder. Shareholders -- the large
7 institutional investors are also finding it difficult
8 to accommodate corporate requests to engage. If
9 you're in the Russell 3000 and not the S&P 500, it is
10 damn hard to get a meeting with an institutional
11 investor. It's hard to get a phone call.

12 MR. BERTSCH: Yeah, I guess I'd just say I
13 think there are some that should be engaging that are
14 not. Clearly, you have a whole range of styles. I do
15 know that the legal departments at asset management
16 firms are very cautious, having dealt with them at two
17 different large asset managers.

18 MR. ROCK: So we have a bit more than ten
19 minutes to go, so I want to give each of you a chance
20 to make a final -- make final comments, and I'll do it
21 in reverse order that we went, and so I'll start with
22 Scott.

23 MR. HIRST: Thank you, Ed. I think now my
24 point is that it's imperative that the debate take
25 into account the incentives of the investment

1 managers. And doing that makes it clear that
2 incentive managers, investment managers have
3 incentives to engage not too much but too little, and
4 so the remedies should not be focused on the
5 possibility of them overengaging and possibly
6 resulting in anticompetitive conduct, that we should
7 be thinking about the problem as how do we have these
8 investment managers that control large parts of public
9 companies engaging with them in thoughtful ways and
10 not being constrained from doing so.
11 MR. HIRSCHMANN: I was thinking here, maybe
12 I've changed my mind. Maybe if I was king for a day,
13 I'd decide which investors to give more power and
14 which investors to take less power, but in a moment of
15 calm reasoning, I think I'd have to be humble enough
16 that I probably couldn't pick the right ones and that
17 whatever scheme I came up with probably would backfire
18 over time.
19 And I think that's the point here. We need
20 to follow the physician's oath and first do no harm.
21 The answer is not to pick winners and losers among
22 investors but really to make sure that the system is
23 allowing everybody to have a seat at the table and to
24 remember that it's not just the way standards are set
25 on corporate governance. It's really also in the

1 court of public opinion. And this is a much more
2 complicated issue than -- which will merit much more
3 conversation, and I’m glad that we’re having it today.
4 MS. GREGORY: So the rise of concentrated
5 ownership in the hands of institutional investors has
6 coincided with much more focus by corporate boards on
7 issues around governance processes, oversight of
8 strategy and risk, accountability to shareholders, and
9 transparency. And I think that there is a causative
10 link there that I would be concerned about interfering
11 with.
12 MS. CORZO: You know, I'm excited to see the
13 Federal Trade Commission getting more active in
14 engaging a lot more on antitrust issues. I've been in
15 Washington a long time and have interacted more with
16 the FTC in the last month than I did in the ten years
17 before that. And from my perspective, that's a good
18 thing.
19 On this particular topic, I find the
20 analysis a little bit perplexing, and it's hard for me
21 to understand both the mechanism that institutional
22 investors would use to influence corporate boards in
23 an anticompetitive way and also the motivation to do
24 it, and so that's where I would close.
25 MR. BERTSCH: I’ll just make one general

1 point and one specific point. General point, our
2 members are often called universal owners. So they're
3 owning the whole economy certainly, the whole publicly
4 listed company economy and actually for the bigger
5 funds, private companies as well. And their interest
6 is in the vitality of the economy, the prospering of
7 the economy broadly, which means that antitrust is
8 actually important.
9 So I think it's very good that the FTC is
10 looking at I think a variety of new thoughts about,
11 you know, where there may be problems, and that's all
12 to the good.
13 That said, in my more narrow -- I'm going to
14 go to my more narrow point. I just don't see it in
15 the common ownership. It doesn't seem compelling to
16 me. And just one thing that Holly said -- mentioned,
17 whatever criticism of ISS and Glass Lewis, the proxy
18 advisory services, is they attempt to reflect their
19 clients, and they heavily reflect the institutional
20 investor community in the United States.
21 ISS in particular, its number one issue
22 could be pay for performance on an industry-relative
23 basis. That's what they’re really pushing. Those are
24 the most salient issues for shareholders and
25 companies. And that seems to me entirely

1 contradictory to the notion that there's not only --
2 not a push for market restraint, but actually there's
3 a voice coming -- the voice coming from the
4 institutional investor community, to the extent that
5 it is, is saying you got to do better against your
6 peers.
7 MS. BENNINGTON: Everybody has said great
8 stuff and I agree with it all. That's all I have to
9 say. No. I've read most of the papers. I read them,
10 and I obviously have my own experience of being
11 involved one way or another with the capital markets
12 for over 25 years, and I don't see it. I read them,
13 but I don't see what the papers are pointing to with
14 the actual results that they're coming out with.
15 My main concern is that the sorts of
16 tweaks that are being proposed are maybe small for
17 antitrust law but they're absolutely enormous -- just
18 enormous -- for the capital markets and for asset
19 management. We have the most robust and competitive
20 capital market system for investors in the world here.
21 And I do worry that this sort of a theory, that if
22 these are put in place, they could do tremendous
23 damage to that system.
24 MS. NOVICK: So a couple of things I wanted
25 to touch on because you're going to hear about these,

1 I'm sure, in presentations this afternoon and I want
2 you to have some perspective. So one of the things
3 that gets said a lot is diversification across
4 industries is enough diversification, why do you need
5 it within the industry? And, so, I'll give you just
6 some examples.
7 In 2017, J.P. Morgan was up 24 percent;
8 Wells Fargo was up 10. In the aerospace industry in
9 2018, Lockheed-Martin was down 10 percent; Boeing was
10 up 17. I don't think I need to say more on the
11 importance of idiosyncratic risk within a sector.
12 The second thing you're going to hear is
13 only rich people invest in mutual funds and so it's
14 not fair that consumer prices for little guys are
15 benefitting the wealthy. So the actual numbers are
16 the median household income of a mutual fund investor
17 is $100,000. That means that half of the investors
18 earned less than that. So I'm not sure what we want
19 to count as wealthy versus not wealthy, but clearly
20 many of them investing in their retirement accounts.
21 So I'm going to dub this whole conversation
22 the Goldilocks problem. You heard from Scott, we do
23 too little. You'll hear this afternoon, we do too
24 much. You'll hear from some in the middle that we
25 seem to do just about the right amount. I actually

1 believe corporate governance, stewardship is a net
2 positive, being active, being involved in these
3 conversations. I don't think it goes anywhere near
4 the topics that are of concern.
5 And, then, lastly, I did want to thank Ed,
6 as well as Martin and Einer, for bringing together the
7 Chamber, the CII, and AFL-CIO to agree on something
8 even in this very political climate today.
9 MR. ROCK: Thank you, Barbara. John Bogle's
10 opinion piece is a really interesting one because he
11 does raise the prospect of if 50 percent -- if we
12 continue at the current rate, if we continue at the
13 current rate, then in not too many years, 50 percent
14 of all assets will be held by the big three and
15 wouldn't that be a cause for concern.
16 One thing to think about in that regard and
17 very much is I think present in this discussion is
18 that the asset manager world is a very heterogeneous
19 world. And there is a natural balance that emerges
20 between actively managed strategies and passively
21 managed strategies. And the more money that goes into
22 the passive strategies, the more profits there are
23 going to be in the active strategies.
24 And, so, the idea that we will get to a
25 point where the big three own 50 percent of all

1 equities and 50 percent of all companies is extremely
2 unlikely, and, of course, there’s always the
3 possibility of new entrants both into the index, the
4 passive strategies as well as into the active
5 strategies. But it is something that, you know, is
6 worth thinking about as we think about the appropriate
7 relationship between shareholders and firms. It's not
8 just one kind of shareholder. There are all sorts of
9 shareholders, and they have different relationships
10 with firms.
11 And Delaware law, for what it's worth,
12 doesn't draw any distinctions among the different kind
13 of shareholders. They let shareholders more or less
14 do what they want to do.
15 We're going to break for lunch until 1:00.
16 And if you will please join me in thanking our panel.
17 (Applause.)
18 (Lunch recess.)
19
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21
22
23
24 **REMARKS**
25 MR. ADKINSON: Good afternoon. My name is

1 Bill Adkinson, and I’m an attorney adviser in the
2 Office of Policy Planning at the FTC. Welcome to the
3 afternoon portion of our proceedings.
4 Before we begin, I’d like to reiterate the
5 instructions that Scott mentioned this morning. I’d
6 like to say that this event is being webcast,
7 photographed, and recorded. By participating in this
8 event, you are agreeing that your image and anything
9 you say or submit may be posted indefinitely at
10 FTC.gov or one of the Commission’s publicly available
11 social media sites. A transcript of today’s
12 proceeding will be posted as well.
13 Question cards will be available throughout
14 the day. Please use them to write down questions for
15 panelists. Staff will collect them and pass them to
16 the moderators, who may pose selected questions if
17 time permits. Finally, if you have your mobile phone
18 with you, please silence it.
19 Thank you. It is my pleasure to start this
20 afternoon's proceeding by introducing Commissioner
21 Rohit Chopra, who was sworn in as a Federal Trade
22 Commissioner on May 2nd, 2018. He was previously a
23 Senior Fellow at the Consumer Federation of America, a
24 Visiting Fellow at the Roosevelt Institute, Special
25 Adviser to the Secretary of Education and Assistant

1 Director of the Consumer Financial Protection Bureau.
2 Commissioner Chopra.
3 (Applause.)
4 COMMISSIONER CHOPRA: Good. It's great to
5 be here, and thank you all for attending the FTC's
6 hearings on consumer protection and competition as we
7 assess how the agency can be more effective in
8 tackling today's problems in the economy. Today,
9 large corporations increasingly dominate the economy.
10 In the past 25 years, Fortune 500 corporate revenue
11 has substantially increased their share of GDP, and
12 the Fortune 100 firms have grown even faster.
13 These corporations are complex, sprawling,
14 with significant power to exert over the economy and
15 democracy. Compared to main-street businesses, these
16 firms are more integrated with Wall Street and global
17 financial markets, and, in my view, these companies
18 frequently do not make decisions in ways that our
19 economics textbooks predict.
20 I want to discuss how Wall Street incentives
21 and corporate governance concerns can distort firm
22 behavior. The FTC should not and cannot ignore these
23 incentives, since they may be the root cause of
24 decisions that break the law. Now, originally,
25 corporations were specifically chartered by state

1 legislatures to help facilitate capital raising and
2 activities that would benefit the public. Unlike
3 charters in Britain that were bestowed by the Crown,
4 states sought to ensure that corporations acted like
5 mini-republics by outlining how elections for
6 directors would take place with the hope that board
7 members would balance interests among shareholders,
8 but that original vision has faded.
9 In today's hearing, many of you have been
10 focusing on the implications of a specific market
11 trend, the increasing dominance of passive equity
12 index funds. But there are many other corporate
13 governance trends that we need to be thinking about.
14 I want to briefly discuss two of these: one, the
15 explosion of corporate debt; and, two, the distorted
16 incentives in executive compensation packages.
17 First, despite earning record levels of
18 profits, the U.S. corporate sector is deeply in debt.
19 From 2007 to 2017, outstanding bonds for nonfinancial
20 corporations in the United States more than doubled
21 from $2.3 trillion to $4.8 trillion. Overall,
22 American companies now owe more than $9 trillion in
23 debt, and the ratio of cash on hand to debt has fallen
24 to one of its lowest points ever.
25 A decade ago, the economy unraveled and

1 highly leveraged Wall Street banks, and homeowners
2 with toxic mortgages were at the center of the storm.
3 And while debt levels went down for both banks and
4 households, debt for nonfinancial corporations has
5 surged. At the time of the crisis, we heard a lot
6 about families who were irresponsible for taking on so
7 much debt, but we didn't hear so much about all of the
8 big companies who did and are doing exactly the same
9 thing.
10 Don't get me wrong. Debt can be useful.
11 Debt can help a shop buy inventory or a manufacturer
12 open up a plant to meet demand. This kind of debt
13 makes economic sense because the investment has real-
14 world cash flows to service that debt, but sometimes
15 debt is used for other purposes that are disconnected
16 from real investment and competition. Playing tax
17 games, buying back stock or snapping up a competitor
18 who might pose a threat are just a few of these
19 examples. And that's where enforcers need to be more
20 wary.
21 But there's other cause for concern with
22 heavy debt loads. When companies borrow too much,
23 they take on more risk. Heavily indebted companies
24 can get desperate and will go to great lengths to keep
25 creditors happy since those lenders control their fate

1 when companies are walking on a tightrope. And that's
2 a situation ripe for illegal behavior. A company in
3 dire debt would have more incentive to save money by
4 taking illegal shortcuts or make money by beating out
5 competitors using illegal practices.
6 One firm that I have closely studied and
7 investigated is called ITT Educational Services, a
8 very large, publicly traded, for-profit college chain
9 that is now defunct. The company started off as a
10 small number of trade schools preparing students for
11 jobs in demand. But as it became hungry to attract
12 Wall Street investment, it took on more debt and
13 engaged in riskier practices.
14 To stay afloat, the company believed it had
15 no choice but to aggressively sign up students for
16 tens of thousands of dollars in loans to enroll in
17 programs of questionable value. Due to its own
18 financial position, investing the time and money to
19 create high-quality programs would have put the
20 company in peril since it didn't have the room to take
21 any short-term losses.
22 Instead, this debt-driven deception has
23 destroyed the lives of so many students and their
24 families who have been crushed by financial ruin.
25 Now, law enforcement eventually took action. The

1 Consumer Financial Protection Bureau, the Securities
2 and Exchange Commission and others sued ITT. The
3 Department of Education sanctioned the company for
4 financial mismanagement, but for the students
5 defrauded by the company, it was too late for any
6 legal action or settlement to fix the damage that was
7 done.
8 In the merger context, heavy debt loads can
9 also cause trouble. And as you know, a common way
10 that antitrust enforcers solve the anticompetitive
11 concerns in a deal is to require divestitures. Now,
12 parties will tell a great story about how a
13 divestiture buyer will become a hard-charging player
14 that will innovate or push down prices. But when the
15 new competitor is loaded up with debt, it can make it
16 much harder or even impossible to compete.
17 In one matter involving discount dollar
18 stores, a private equity group purchased several
19 hundred stores that were required to be divested as
20 part of a merger. But instead of proving to be an
21 upstart challenger, the private equity fund that
22 bought those stores ended up selling them to another
23 large industry competitor after telling the FTC it
24 could no longer operate as a viable standalone
25 business.

1 In these deals, that debt doesn't stick with
2 the private equity buyer. It typically remains a
3 burden on the business until the debt is paid or until
4 the business dissolves, raising even more questions
5 about when competition will be restored.
6 In a recent matter that came before the
7 Commission recently, two massive industrial gas
8 corporations, Praxair and Linde sought to merge to
9 become even bigger, raising a host of anticompetitive
10 concerns. While these may not be household names,
11 industrial gases are the inputs to an extremely wide
12 range of goods produced in our economy.
13 Due to some nuances with this deal, the FTC
14 was in an unusual position to negotiate a remedy or to
15 block the deal outright. To address certain overlaps,
16 the parties sought to divest assets. Now, I expressed
17 concerns about the divestiture buyer’s debt level and
18 whether this would jeopardize their ability to grow
19 and compete vigorously. The whole reason to divest
20 assets is to create a meaningful competitor in a
21 market where a merger puts competition in jeopardy,
22 but that hope for competition will not exist for very
23 long or at all if the would-be competitor goes
24 bankrupt or runs the divested assets into the ground
25 by selling off their most valuable pieces to service

1 their debt.
2 While I hope these concerns do not
3 materialize, the significant chance that they could
4 says to me that we need a new approach to evaluating
5 financial condition of divestiture buyers. We could
6 start by taking a page from the business playbook.
7 Sophisticated lenders go to great lengths to protect
8 themselves when extending credit. They include
9 provisions that require corporate borrowers to keep
10 enough cash on hand; they accelerate repayment when a
11 firm is sanctioned by regulators; they even forbid
12 questionable payouts to investors and management. And
13 when things go wrong, these lenders make sure they get
14 paid way before any government fine comes due.
15 If Wall Street creditors can protect
16 themselves from getting burned in these situations,
17 enforcers should consider using similar provisions to
18 protect the public. And if those provisions are
19 impossible, I would argue that we are better off
20 seeking to block a deal than allowing one through that
21 includes divesting to a high-risk buyer.
22 Second, excessive executive compensation is
23 a virus in the economy that is distorting incentives.
24 Consumer protection and competition regulators and
25 enforcers cannot ignore this. CEO pay in particular

1 has risen dramatically. Now, many might believe that
2 CEOs are increasingly more important to corporate
3 performance than an average worker, but are top
4 executives in many industries really ten times on an
5 inflation-adjusted basis more valuable than their
6 predecessors from a generation ago? Many long-term
7 shareholders are saying no.
8 As many of you know in 1993, Congress and
9 President Clinton discussed capping the deductibility
10 of executive pay at $1 million. There was a big
11 exception for performance-based pay. This policy
12 change created momentum for compensating executives
13 with stock options and stock grants. With stock
14 options, executives are paid for any gains the
15 company's stock makes over a certain price for a
16 particular period of time. With stock grants,
17 executives receive actual shares of the company, but
18 they're often required to hold on to them for a
19 certain amount of time.
20 These compensation vehicles are intended to
21 align the interests of executives with those of long-
22 term shareholders, and sometimes they can. But
23 according to some evidence, these performance-based
24 incentives may actually lead to unnecessary risk
25 taking or even law breaking. Stock options, in

1 particular, have no value unless a stock price exceeds
2 the price at which the option can be exercised or the
3 strike price.
4 In other words, if there's no stock
5 appreciation before that expiration date, it's
6 worthless. This can lead to executives taking risks
7 by operating on the margins of the law to create those
8 short-term gains that make options valuable.
9 According to a 2016 paper, a stock-option-
10 heavy executive compensation package drastically
11 increased the likelihood of a corporation breaking
12 environmental laws or engaging in financial
13 misconduct. But even stock grants come with risks for
14 executives reluctant to see their net worth decline.
15 Take the pharmaceutical industry.
16 Executives with stock grants may not see big short-
17 term payoffs from doing what they're supposed to do --
18 curing disease by making life-saving drugs. Inventing
19 new drugs takes time and money, and that's why the
20 public grants them patents and exclusivity periods
21 that can often result in a monopoly. But many firms
22 do not want to fully embrace capitalism by competing.
23 They look to preserve their company's stock price and
24 their personal wealth. So, instead, they focus quite
25 a bit of energy on blocking generic competition to

1 drugs that have long been on the market.
2 Indeed, by shifting the focus from making
3 medicine to making themselves rich, I worry that some
4 pharma companies and their executives seem to be
5 acting like patent trolls. Filing frivolous patents,
6 making minor or cosmetic modifications to drugs, and
7 playing other patent games allows them to keep raking
8 in government-granted monopoly profits. The longer
9 they maintain their monopoly rents, sometimes through
10 breaking the antitrust laws, as we've seen at the FTC,
11 the lower the chances these executives will see their
12 company stock price and their personal net worth
13 decline.
14 But even if their company is caught, it
15 might be too late because they might have already
16 cashed out. The decision to cheat consumers or rig
17 the market or otherwise break the law can provide big
18 payouts to executives sometimes. But when it comes to
19 paying fines, the ones who call the shots rarely face
20 accountability. Executives tell shareholders that
21 this is the cost of doing business.
22 Now, it is critical that we understand how
23 these executive compensation incentives might drive
24 misconduct or when a defendant is keen on settling,
25 whether we need to address those distorted incentives

1 directly. There have been instances where enforcers
2 have required significant changes to executive
3 compensation policies. For example, in the civil and
4 criminal settlements with GlaxoSmithKlein and Johnson
5 & Johnson, the corporations were required to amend
6 their policies to ensure adequate clawback provisions
7 from executives when law breaking occurred.
8 The role of heavy debt and executive compensation
9 in both consumer protection and competition matters
10 raises many questions about our approach to settlement
11 remedies. When we find that heavy corporate debt
12 poses risk, how should we safeguard against it?
13 Should enforcers, like creditors, seek bans on stock
14 buy-backs and dividend payouts until debt levels and
15 risk levels get under control? Should enforcers
16 require recapitalizations, including raising equity
17 capital when companies claim they cannot afford to
18 make victims whole?
19 Should we require the company to sell off
20 assets to pay back victims when wrongdoing is found?
21 Should we require clawback provisions to stop
22 executives from getting a windfall if consumers are
23 cheated again? Should we seek compensation
24 arraignments where executives guarantee payments to
25 victims if companies go belly up? Should we require

1 more attestations signed by executives or board
2 members that they have no personal knowledge of any
3 wrongdoing?
4 There are many questions that we need to be
5 asking about corporate governance and corporate
6 governance remedies if we want to be taken seriously
7 by potential bad actors in the boardroom.
8 So thank you for taking part in our
9 examination of our approach to consumer protection and
10 competition with today's focus on capital markets and
11 corporate governance. While we are just scratching
12 the surface today, this must be a start of changing
13 our approach to face the realities of an economy
14 dominated by large firms. Thank you.
15 (Applause.)
16 MR. ADKINSON: Thank you, Commissioner
17 Chopra.
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1 **PRESENTATIONS - COMMON OWNERSHIP**

2 MR. ADKINSON: We will now have two 20-
3 minute framing presentations. First will be Dan
4 O'Brien, an Executive Vice President at Compass
5 Lexecon. Dan was Deputy Director of the FTC's Bureau
6 of Economics, and prior to that was Chief of the
7 Economic Regulatory Section at the DOJ Antitrust
8 Division.

9 Dan coauthored some of the main theoretical
10 work underlying the analysis of competitive impacts of
11 cross ownership and common ownership in competing
12 firms.

13 Dan?

14 MR. O'BRIEN: Thank you, Bill. I'm pleased
15 to be here today with such a distinguished group to
16 discuss common ownership, which I think is a very
17 important topic for the FTC and other competition
18 authorities around the world.

19 Last week, my good friend, Martin Schmalz,
20 tweeted that it was bad form for the FTC to include me
21 on the program without my disclosing past consulting
22 work that I've done relating to common ownership.

23 So, Martin, I think you know better than
24 that. I've been an academic. I've been a government
25 policy wonk, and I've been a consultant. And in each

1 of those positions, I've been fortunate enough to
2 publish articles in the top peer-reviewed journals in
3 my field. And, frankly, I find it a little bit
4 insulting that you would insinuate in public through a
5 tweet that my remarks today are somehow tainted by
6 some consulting work that I did for the industry.
7 I think you'll find that my analysis today
8 is just that, it's analysis. But since you raised
9 the question, I'm not being compensated for my
10 participation or my remarks today, and I have not been
11 paid by a third party for work on common ownership for
12 over a year.
13 That said, I agree with you, Martin, that
14 there is value in knowing what drives research
15 forward. And with that in mind, I'm going to tee up
16 my discussion today in a way that fully discloses my
17 research and my consulting work on common ownership.
18 Okay. So in the mid '90s, I coauthored a
19 paper titled "The Competitive Effects of Partial
20 Ownership, Financial Interest, and Corporate Control."
21 At the time, I was consulting with cable TV companies
22 about transactions that involved changes in partial
23 ownership interest. And we needed a way to analyze
24 the problem. So the result was this academic paper,
25 which probably would not have been written without the

1 motivating consulting work. And I've published a
2 number of papers motivated by consulting work in the
3 same way.
4 The paper develops a very general theory
5 that explains how partial common ownership can have
6 anticompetitive effects. And it shows how one can
7 quantify those effects. Eighteen years later, Martin
8 and coauthors published a very important paper
9 examining common ownership in the airline industry
10 that by all appearances draws heavily on the
11 theoretical framework that I helped develop in
12 conjunction with my colleague at the time, Steve
13 Salop.
14 Our framework was really the only rigorous
15 theory of how common ownership could harm competition
16 at the time. And, in fact, newer theories that are
17 coming out tend to build on the earlier framework. So
18 in particular, Azar, Schmalz, and Tecu, they drew on
19 our paper for the key explanatory variable in their
20 analysis, the modified Herfindahl-Hirschman index, or
21 MHHI.
22 I became aware of Azar, Schmalz, and Tecu's
23 paper in 2015 while I was at the FTC. It's always
24 gratifying when your own research is used by others,
25 but I had several concerns about how they applied the

1 theory of partial ownership to the common ownership
2 question. I published a critical review in the ABA's
3 Transportation, Energy, and Antitrust newsletter that
4 same year. And in my review, which was not funded by
5 any third party, I touched on many of the issues that
6 I'll discuss in a few moments.
7 That same year, while at the FTC, I began
8 working on a technical paper that dissects some well-
9 known and some less well-known problems with price
10 concentration regressions, which was the methodology
11 used in Azar, Schmalz, and Tecu. That paper also
12 received no third-party funding, by the way.
13 Then in 2017, I wrote a note for the OECD on
14 common ownership raising many of the same issues.
15 That paper also received no funding. Finally, also in
16 2017, I coauthored two papers, one that's now
17 published, critical of the application of the theory
18 that I helped develop to the issue of common ownership
19 by institutional investors. Okay, those papers did
20 receive funding from ICI, as is fully disclosed on
21 those papers. And they make the same points
22 essentially that I am going to make today and that I
23 had made previously, before I even knew who ICI was.
24 So that brings us to today. And as I said
25 earlier, I'm here really on my own dime, but it seems

1 more like a quarter because New York is very
2 expensive.
3 Okay. So this short history of my
4 involvement in research and consulting on common
5 ownership kind of tees up my topic for the session,
6 which is the application of the theory of partial
7 ownership to questions about common ownership by
8 institutional investors. This is a narrow focus, but
9 I think it's an important one because I think it's
10 important for the theory that motivates empirical
11 analysis to be appropriate to the question at hand.
12 I think it's fair to say that we're here
13 today in large part because of the empirical findings
14 in Martin's important papers. I find that when the
15 level of policy interest in new research reaches a
16 certain decibel level, it often makes sense to pause,
17 take a 40,000-foot view of the landscape, and make a
18 reasoned assessment. And that's what I hope to do in
19 the next 15 minutes.
20 First, what is partial ownership and why do
21 we need a theory about it? So most economic theory
22 and most applications of economics to policy assume
23 that the firm is a monolithic decision-maker whose
24 objective is to maximize profits. The economics we
25 see in textbooks is built on this assumption.

1 Of course, this assumption is an
2 abstraction. With the exception of a sole
3 proprietorship, firms typically have more than one
4 owner, and each owner partially owns the firm. If the
5 owners agree that the firm's objective should be to
6 maximize the profits of the firm, then the assumption
7 that the firm behaves as a monolith is fine. But if
8 different firm owners want the firm to pursue
9 different objectives, for whatever reason, how will
10 the firm behave?
11 Okay, the theory of partial ownership that
12 Steve and I worked out was developed to answer this
13 question. The theory provides a way to model how
14 firms behave when a firm's owners have divergent
15 interests. The theory then analyzes how markets
16 function when firms pursue this objective, which could
17 be quite different from the standard objective of
18 maximizing own firm profits.
19 Okay. So I've been using the term “partial
20 ownership.” Where does common ownership fit in?
21 Common ownership occurs when one or more owners of a
22 company also owns one or more other companies. The
23 FTC discussed a more nuanced definition earlier today,
24 but I'm sticking with the analytical definition that
25 works for economists when we think about this, okay?

1 The companies are said to be commonly owned
2 in this case because they have some owners in common.
3 A pure horizontal merger, for example, is a special
4 case of common ownership technically, where the
5 merging firms become commonly owned. That may be
6 inconsistent with discussions of common ownership
7 policy and legal discussions, but analytically, that's
8 true.
9 Interesting questions arise, though, when
10 common ownership also involves partial ownership.
11 When different partial owners have different common
12 ownership interests in firms whose profits are
13 interrelated in some way, different owners are apt to
14 have divergent interests. For example, a noncommon
15 owner that holds share in Company A wants Company A
16 managers to pursue strategies that maximize the
17 profits of Company A, but a common owner that owns
18 shares of Company A and Company B wants the manager of
19 Company A to compete less aggressively to increase its
20 returns from its partial ownership of Company B.
21 This shows how different degrees of partial
22 common ownership by different owners create divergent
23 interests among the owners. The theory of partial
24 ownership was built to address this situation, as I
25 said.

1 So how does the theory do this? How does
2 the theory -- what does the theory assume about what a
3 firm's managers do when owners have divergent
4 interests? Well, the theory assumes, naturally
5 enough, that managers pursue strategies that are in
6 the interest of the firm's owners. In particular --
7 and this is the key assumption of the theory on which
8 the empirical work was based -- each manager maximizes
9 a weighted average of the returns to the firm's owners
10 from their shareholdings in the relevant common
11 ownership group. That's a lot, okay?
12 There's a lot in that statement, so I want
13 to take it apart because the usefulness of the theory
14 for understanding specific cases of common ownership
15 depends on the accuracy of the assumptions that relate
16 to the three elements that I underlined -- the control
17 weights, returns as an objective, and the relative
18 common ownership group.
19 Before carving into these assumptions, I
20 want to just stop and say, you know, what about this
21 theory, is this theory goofy, or do we think it's
22 okay? So what are the scholarly views of the theory?
23 I think generally positive. And I say that based on
24 two observations. First, much of the literature on
25 the subject uses the theory either as a starting point

1 for extending it or to motivate empirical work.
2 And, second, my experience on the kind of
3 presentation trail of work related to common ownership
4 is that folks don't find the theory itself
5 objectionable. Okay. But that said, like any theory,
6 it comes with warning labels, and they relate to the
7 three elements that I had underlined on the preceding
8 slide, which I now want to go through.
9 So the first warning is that serious side
10 effects may occur with improper control weights, and
11 I'll explain what I mean by that in a minute. The
12 second warning is that you should consult your doctor
13 before using this model if your relevant common
14 ownership group includes antitrust markets beyond the
15 market at issue. And a third warning label is consult
16 your doctor before using this model if owners'
17 objectives differ from investment returns. Those are
18 three warning labels I want to discuss in the rest of
19 my talk.
20 These three warning labels raise troubling
21 issues for using the theory of partial ownership to
22 assess the competitive effects of common ownership by
23 institutional investors. Okay, so the first warning
24 label relates to control weights. Remember that the
25 theory assumes that managers care about the returns to

1 their owners, but because the owners typically have
2 different ownership interests, the manager has to
3 decide how much weight to give each owner in deciding
4 what to do, okay? The weight given to a particular
5 owner is the owner's control weight.
6 In the theory, this is just a number between
7 zero and one such that the control weights sum to one
8 for a given firm. The manager is maximizing a
9 weighted average of the interests of the owners. In
10 practice, the value of these weights that lie between
11 zero and one is really critical. If common owners'
12 control weights are zero, for example, common
13 ownership has no effect. And if the control weights
14 are positive, it can have anticompetitive effects, the
15 size of which depends in a somewhat complex way on
16 financial interests and control weights.
17 Here's a bit of economic humility.
18 Economists do not have robust tested theories about
19 how common ownership -- about how ownership shares
20 translate into control weights. José Azar, one of the
21 coauthors of the airline paper that brought us here
22 today, I think it's fair to say, has a nice paper from
23 his dissertation that provides one motivation of what
24 Salop and I called proportional control, which occurs
25 when managers give their owners weights equal to their

1 ownership shares.

2 I think José's paper is interesting. It was
3 alluded to in an earlier discussion today, and I
4 recommend reading it, but it's one motivation for
5 proportional control. It's not especially compelling
6 for many reasons. It's a long discussion. And it's
7 not been tested.

8 Other approaches to control use cooperative
9 voting models, such as the Banzhaf power index,
10 Shapley's voting model and so on. These approaches
11 are also not well tested.

12 So the question is what are the appropriate
13 control weights. The assumptions about control in the
14 empirical literature also raise additional puzzles,
15 okay? Suppose a company is owned by a set of common
16 owners and a set of noncommon owners that have very
17 small shares. The noncommon owners have very small
18 shares, so the noncommon ownership is diffused.

19 Under proportional control, okay, which is
20 the assumption in -- Azar, Schmalz, and Tecu used to
21 create the modified Herfindahl-Hirschman index -- they
22 also considered Banzhaf control -- if the number of
23 noncommon owners is large, those owners have
24 essentially no say, okay, in the direction of the
25 firm. Their control weights are near zero.

1 On the other hand, a common owner that holds
2 even 1 percent of the firm has almost complete control
3 over the firm. Okay, so, is this assumption
4 reasonable? That's a prediction of the theory that if
5 ownership by noncommon owners is diffuse, they have no
6 control. Is this assumption reasonable?
7 Well, experts in corporate finance --
8 corporate law, rather, they say no. In the U.S., a
9 firm's directors have a fiduciary obligation to the
10 firm and to the owners as to their interest in the
11 firm. In other words, the law technically obligates
12 directors to pursue objectives that are in the best
13 interests of the firm, which means they should not
14 place weight in their objective functions on the
15 returns of shareholders from their ownership in rival
16 firms.
17 Now, I won't stand here and say that common
18 owners can never influence management to pursue
19 strategies contrary to noncommon owners' interests,
20 but I'll note that compensation of managers in most
21 major U.S. corporations is based on a firm's stock, in
22 part, and this gives the manager at least a short-run
23 incentive to price in a way that maximizes the profits
24 of the firm consistent with fiduciary obligation and
25 inconsistent with anticompetitive effects from common

1 ownership.

2 In the interest of time, I'm going to skip
3 ahead to Warning Label 2. This relates to what I’ve
4 called the relevant common ownership group. Okay,
5 this group consists of firms that are commonly owned
6 and whose profits are interrelated. For example,
7 airlines that are commonly owned and compete with each
8 other are in the same relevant common ownership group.

9 In addition, if the airline suppliers and
10 customers are also owned by the same common owners,
11 they should also be included in the relevant common
12 ownership group. Azar, Schmalz, and Tecu’s paper
13 assumes that the relevant common ownership group
14 consists of the airlines and only the airlines.
15 However, the same institutional investors that own the
16 airlines also own airline suppliers and customers.

17 Okay, why is this important? Well, under
18 AST's assumption, institutional investors ignore the
19 impact of airline prices on airline suppliers and
20 business travels. And an increase in airfares has a
21 negative effect on both groups. Both impacts give
22 common owners incentives to lower price rather than
23 raise it.

24 Similarly, in the European Commission's use
25 of the MHHI to analyze the Dow/DuPont merger, they

1 assumed that institutional investors would ignore the
2 impact of agrochemical companies' strategies on their
3 suppliers and buyers, which institutional investors
4 also partially own. These impacts can give common
5 owners incentives to reduce price rather than raise
6 it.
7 In the interest of time, I'm going to go on
8 to Warning Label 3, which is that owners' objectives
9 differ -- institutional investors' objectives differ
10 significantly from the objectives of owners that are
11 not institutions. Okay? Institutional investors make
12 money by attracting retail investors. Is this
13 accomplished by instructing Company A to pull its
14 competitive punches against Company B to increase the
15 value of the institution's shareholdings in Company B?
16 That is, should Vanguard instruct United Airlines to
17 raise price to increase the value of its position in
18 American Airlines?
19 What if Fidelity owns a larger share of
20 American than Vanguard? Then Vanguard's strategy
21 would increase the value of Fidelity's portfolio more
22 than the value of its own portfolio. Is this
23 something Vanguard wants to do? The point is that
24 institutional investors that purchase shares for
25 retail investors have vastly different incentives than

1 investors that purchase shares for themselves. The
2 theory of partial ownership was built to capture the
3 incentives of investors that purchase their own
4 shares. It was not built to capture the incentives of
5 institutional investors. And, in fact, I'm not sure
6 we have a real good idea at this point of what those
7 incentives are. We really need a theory of how
8 institutional investors compete with each other and
9 the implications of this competition for how they
10 behave to influence managers before we can apply the
11 theory to the question of common ownership by
12 institutional investors.
13 So I'm going to conclude by summarizing
14 circumstances where I think the theory of partial
15 ownership is properly and improperly applied. The
16 theory can be quite useful when three conditions are
17 satisfied. Control weights are reasonably clear or
18 can be bounded. The relevant common ownership group
19 is properly defined. And owners have the objective of
20 maximizing their returns across the relevant ownership
21 group.
22 These conditions often hold in transactions
23 that involve changes in partial ownership among a few
24 large companies or investors, but for common ownership
25 by institutional investors, control weights are not

1 clear; research has not properly identified relevant
2 common ownership groups and there's a mismatch between
3 the objectives of asset managers and the objectives
4 assumed by the theory.
5 Thank you very much.
6 (Applause.)
7 MR. ADKINSON: Thanks, Dan.
8 Our second presenter is Martin Schmalz, an
9 Assistant Professor of Finance at the University of
10 Michigan's Ross School of Business. As mentioned by
11 Dan and also this morning, Martin and his coauthors
12 have written the seminal papers finding that common
13 ownership in competing firms has anticompetitive
14 effects.
15 He is a financial economist whose work
16 examines how finance interacts with other fields of
17 economics, including industrial organization, labor
18 economics, monetary economics, and microeconomic
19 theory.
20 Martin?
21 MR. SCHMALZ: Thank you very much for having
22 me and for holding this hearing and to NYU for hosting
23 it. So I'd like to state for the record that I do
24 hold a portfolio of ETFs but have no other conflicts
25 of interest to disclose.

1 So I want to take a much broader view on
2 what the theoretical literature on this topic has
3 shown and also speak about governance mechanisms and a
4 few words on policy. So let me start with a benchmark
5 model of competition that is really what we should
6 think about, similar to what Adam Smith described in
7 his *Wealth of Nations*.
8 So what he imagined is a baker that is
9 completely self-interested and tries to, you know,
10 innovate and work very hard to undercut the bakery on
11 the other side of the street and thereby compete for
12 market share for new customers. This self-interest
13 leads to a maximization of social welfare.
14 Now, a key assumption here is that each firm
15 wants to maximize its own value and that assumption is
16 naturally satisfied when the firm's owner-managed and
17 the owner's wealth is concentrated in one firm. Okay,
18 so what's an example, though, of today's corporations
19 where managers and owners might differ?
20 Here's one illustrative example. Virgin
21 America used to be an airline. The largest
22 shareholder is Richard Branson, not the CEO, and you
23 ask yourself, how is it, by which mechanism is it that
24 owners get firms to compete aggressively? They won't
25 do it on themselves -- by themselves without

1 incentives. And the media reports point to explicit
2 directions by the owner to use the cash from the IPO
3 for capacity expansions, buying new airlines, opening
4 new routes, just expanding market share, stealing
5 market share from Delta, United, and the other
6 shareholders.
7 Of course, he has the power to vote and can
8 design incentives to break up this voice channel.
9 Here’s a quick illustration of to which lengths such
10 an owner can go to attract market share. This is
11 Richard Branson, you know, trying to attract market
12 share from other players.
13 Now, I’m kind of serious about this because
14 a key question is, who takes that role? Who puts on
15 the lipstick at Delta and United and Southwest
16 Airlines? To find out, let's find out who the largest
17 owners are. Well, the largest shareholder of Delta
18 and Southwest and United is Berkshire Hathaway, and
19 that’s Warren Buffett's investment firm, who is also
20 the third largest in Berkshire Hathaway, and the other
21 owners are Vanguard, BlackRock, PrimeCap, State Street
22 in some proportion.
23 So who is supposed to put on the lipstick?
24 Warren Buffett? No? First at Delta and then at
25 United? Well, that seems absurd, no? And that’s the

1 point. The point is he has no economic incentives of
2 doing that. If you steal market share from Southwest
3 Airlines, you know, you call Delta and say steal
4 market share from Southwest; and you hang up and say
5 call Southwest and say now you steal market share from
6 Delta; hang up, then you call United. That's
7 completely absurd. It's against economic interests of
8 a common owner. And I use Scott's words from this
9 morning, common owners simply have weak incentives to
10 engage in stewardship aimed at enhancing the value of
11 particular companies, but they do have incentives to
12 defer to the preferences of corporate managers.
13 The question is what happens then. You
14 know, what happens is the corporate manager has weak
15 incentives to cut costs, then the costs are going to
16 be higher, output is going to be lower and illustrate
17 equilibrium, and product price is higher. That's an
18 anticompetitive effect, okay?
19 So the key insight is nobody needs to soften
20 competition if there are no incentives to compete in
21 the first place. That's a key insight. Okay, let me
22 give a few more empirical facts. The thing is, common
23 owners are not in the minority as we've heard much in
24 this debate. There are almost no noncommon owners
25 left. If you look at the largest 100 shareholders of

1 United that own more than 91 percent of the shares,
2 five of these shareholders are not common owners; 95
3 of them are. The largest of these noncommon owners is
4 number 42. Okay, we have absolutely no power,
5 according to any theory I'm aware of, in these firms.
6 And that's similar for American, Delta, and Southwest.
7 There have been some claims in the
8 literature suggesting otherwise, but if you read
9 Einer's new paper he just posted, there's a correction
10 to that record.
11 Okay, now, what happens in theory when you
12 have few such investors left? There's three decades
13 starting in the '70s of formal theories and informal
14 writings, suggesting that compared to the text model,
15 you'll get less competition if there are less
16 incentives to do so. Okay, this is not a brand-new
17 theory. And all of them have a similar logic that I
18 just explained. Okay, so let me give some details.
19 It is true that the theory doesn't
20 distinguish between asset owners or asset managers.
21 You can either believe that asset owners have an
22 incentive to maximize the total value of the shares in
23 the management, or that they stick to the fiduciary
24 duty by which they promise that they will do that for
25 -- on behalf of its investors. But future work can

1 figure out if that's an empirically important
2 distinction, okay?
3 Another thing I should point out is I
4 totally agree with Dan that we have no empirical
5 evidence or established theory that explains how
6 different common owners or different shareholders
7 get the firm to have an objective function and how,
8 therefore, they behave. What we do have is a paper
9 by a Nobel Laureate, Oliver Hart, that says one
10 thing we know is they won't agree on own-firm profit
11 maximization, and that’s a key assumption in all of
12 traditional antitrust.
13 So I agree with everybody that robustness is
14 needed in applications when it comes to the choice of
15 control weights. Once more, the theory is saying that
16 common ownership reduces incentives to compete. None
17 of these theories says if common owners do nefarious
18 things or incite collusion or do something like
19 intentionally elicit, and that is clear from page 1 of
20 the first formal theory on this topic, suppose no
21 collusion is possible.
22 Rotemberg says, note that this collusion
23 need not be enforced. Managers never need to meet
24 with each other. He also writes, you know, the
25 mechanism for the collusive outcomes is reduced,

1 incentives to compete simply as a result of managers
2 looking out for their shareholders. So these
3 responses we've heard by the investor community, we
4 don't ask for them to collude. We don't collude with
5 anybody. It has just little to do with what the claim
6 is.
7 That's a very important distinction because
8 if you're waiting to find a collusive mechanism by
9 which the investors or firms collude and you don't
10 find any, that's the prediction of the theory, okay?
11 So you're likely to find false negatives, and
12 everybody should be aware of that distinction.
13 Now, what corporate governance tools do
14 common shareholders use? Well, as a first order, all
15 those that are available to them. That's voting,
16 designing incentives, or voice, speaking to portfolio
17 firms. And I'll show you just some examples of
18 apparent deliberate attempts to reduce competition
19 with these firms.
20 Now, the important thing is academics are
21 not going to produce much of this evidence because we
22 don't have access to the data. That's where the role
23 of the regulators would come in. First is let's talk
24 about incentives. Here's an empirical fact. If you
25 measure which fraction of firm value goes to the CEO,

1 that's wealth performance sensitivity, and regress
2 that on some measure of common ownership concentration
3 -- and by the way, this is robust to using other
4 measures rather than MHHI -- you get a negative
5 correlation between those, and it's robust, a very
6 robust finding.
7 So what does it mean? Well, it means that
8 the CEO has reduced incentives to cut costs, which
9 means costs are going to be higher, which means output
10 is lower, which means prices are higher. That's an
11 anticompetitive effect. So what you get is this
12 apparent paradox that it can be a weak principal in
13 corporate governance and at the same time the cause
14 for anticompetitive effects. Okay.
15 Now, there's been some debate in the
16 literature about the use of relative performance
17 evaluation. Now, whether or not a contract features
18 that is completely uninformative about its competitive
19 incentives because everything depends on how you
20 measure performance. Do you measure performance in
21 terms of value, in which case it can be
22 procompetitive, or in terms of margins? And to see
23 that, here's one equation. Margins are price minus
24 marginal cost, and usually prices fall when quantities
25 are higher, but then maximizing margins means

1 minimizing quantity.
2 And Rock and Rubinfeld in their paper point
3 out that in American Airlines, the CEO’s incentives
4 are actually 100 percent based relative income,
5 margins relative to the competitor, so that's actually
6 an anticompetitive type of contract.
7 Now, how relevant is this not only in the
8 data but, you know, anecdotal? If you read the *Wall*
9 *Street Journal*, almost exactly a year ago, you find a
10 group of investors meeting in New York, trying to
11 figure out how they can change executive incentives to
12 reduce the output the frackers produced. That seems
13 to me like a discussion about common -- about product
14 markets, let's talk about voting.
15 And it is true that many institutions don't
16 put their own employees on the board, but, of course,
17 they vote on everybody else, all the directors. Two
18 years ago, Warren Buffett's deputy CIO, Todd Combs,
19 was named to J.P. Morgan's board, the largest
20 shareholders there are BlackRock, Vanguard, and State
21 Street, Fidelity.
22 Now, Bloomberg also pointed out that
23 Berkshire is the largest shareholder in Wells Fargo as
24 well as in Bank of America and many other -- and holds
25 large stakes in many other banks -- U.S. Bank

1 Corporation, Goldman Sachs, American Express, and so
2 forth. So -- and, of course, you can kind of predict
3 that Combs is not going to propose competitive
4 strategies or a price war there.
5 One of the instances in which voting is most
6 important might be activism. If you're a large
7 investor or the largest investor in a firm, it doesn't
8 matter whether you like it or not, but you'll be
9 pivotal in many elections. And we just spoke about
10 Trian this morning. They had in the proxy find at
11 DuPont in which they explicitly asked for increased
12 R&D spending, more relative performance evaluation as
13 measured by value, and all with the explicit goal to
14 increase market share.
15 Now, they were voted down by BlackRock,
16 State Street, Fidelity, each of which was a pivotal
17 decision. And it's not me who concluded alone but a
18 prominent corporate law scholar said the most
19 plausible hypothesis is that the large asset managers
20 are concerned about the impact of activism on the
21 broader portfolio.
22 And Commissioner Jackson this morning
23 mentioned that if you talk to any person in this space
24 they'll confirm that they call them index funds,
25 control America, that they’re pivotal in all these

1 proxy contests. We know in the established literature
2 that hedge fund activism affects product markets. So
3 if mutual funds affect hedge fund activism, we know
4 there's an effect on product markets.
5 I don't have time to go through the
6 exploding literature on mutual funds' pivotal role in
7 proxy contests. I'll just say as early as 2008 in the
8 standard finance journals, we have established that
9 funds vote not in the interest of the individual firm
10 but in the interest of their portfolio, which is very
11 much consistent with the assumptions of the
12 literature.
13 Now, let's switch gears. Okay, let's go to
14 Southeast Asia and private equity. If you read *The
15 Economist*, you'll find claims that the Vision Fund by
16 Softbank explicitly asked Uber and the ride-hailing
17 firms to compete less feverishly and push up fares.
18 It ended with Uber withdrawing from particular markets
19 in exchange for cross ownership stakes, and
20 competition authorities in Southeast Asia challenged
21 these deals.
22 So do we see communication also about
23 product markets in the U.S.? Well, so, this morning,
24 we had a representative of ValueAct here. There was a
25 U.S. lawsuit by the DOJ against ValueAct for a

1 violation of the Hart-Scott-Rodino Act, a filing
2 requirement.
3 Now, what Reuters reports is that this puts
4 -- rings alarm bells in the $16 trillion mutual fund
5 industry because the communications the mutual funds
6 have are very similar to those that were cited in this
7 lawsuit and that the case comes as active and passive
8 investors work more together to pressure management at
9 underperforming companies and that activist core
10 passive shareholders and passive investors recruit
11 activists, so I don't think this distinction between
12 active and passive is all that important in that
13 debate, but, you know, empirically, we can figure this
14 out.
15 Okay. So one might think that this was a
16 warning shot. So the question arises, were topics
17 touching on product market competition discussed
18 since. Well, actually, this fracking case I mentioned
19 happened long after that, so, yes, it did. A few
20 weeks ago, we had an institutional investors meeting,
21 and perhaps we were all happy about this, to be clear,
22 about, you know, reforming how guns are made or how
23 easily they should be trackable and so forth.
24 Larry Fink is on the record saying we can
25 tell a company to fire 5,000 employees tomorrow, and

1 at the same time, we hear they insist no effect on
2 product market outcomes. Now, in Germany, my
3 translation of a headline is “Fund Giant BlackRock
4 Lobbies for Mergers of European Banks.” Now, that is
5 precisely what the Hart-Scott-Rodino Act was supposed
6 to prevent. So, apparently, mechanisms exist for
7 mergers, then I don't understand how mechanisms don't
8 exist for affecting product market outcomes.
9 Okay, so there's more. Matt Levine pointed
10 this out. In earnings calls, common shareholders
11 saying I’d like Southwest to boost fares and also cut
12 capacity, it’s mysterious to me how anybody could
13 think that owners don't have the ability to engage on
14 topics that affect product market outcomes.
15 Okay, so let me now move on and conclude.
16 Given the theory we have and the magnitude of
17 anticompetitive incentives documented -- we'll speak
18 about this afternoon -- as well as a fiduciary duty of
19 the asset managers to maximize the value of the
20 portfolios of assets, as well as the abundance of
21 mechanisms that at least potentially yield ability to
22 affect product markets, we need overwhelming empirical
23 evidence that anticompetitive incentives from common
24 ownership never in any markets cause anticompetitive
25 outcomes.

1 And I don't think we have any evidence to
2 that effect. I'll mention about two dozen papers in
3 the panel later on. Many of them published in top
4 journals that document the facts on prices, outputs,
5 product market conglomeration, innovation, and many
6 other outcome variables we care about here, so I don't
7 think it is warranted to just focus on one particular
8 paper.
9 So the question arises of what we should do
10 about the issue. And, to me, two things stand out.
11 First is collecting better data. It’s a huge pain to
12 deal with common ownership data. Chris Conlon will
13 speak about this later on. But for private firms, we
14 don't even know who owns them as researchers.
15 And I want to just make clear, if anybody
16 uses an HHI screen, you are assuming that even if 100
17 percent of the shareholders of two firms completely
18 overlap, 100 percent shareholder overlap, they should
19 be treated as completely independent firms. You have
20 six shareholders, each owning 15 percent, and the
21 antitrust establishment goes completely independent
22 firms, no impact, because they hold less than 15
23 percent. What they hold cumulatively we completely
24 ignore.
25 This doesn't make sense in economic theory.

1 We have absolutely no evidence that supports that
2 assumption, so, therefore, I think we should challenge
3 it. Now, there are many open questions, and we'll
4 raise many of them. Dan has mentioned a few of them.
5 You know, potential criticisms of what's being done in
6 the literature. And academics will study those, I'm
7 quite confident, but there are many questions
8 academics can't study because we don't have the data
9 for it. And I think that's where the regulators come
10 in.
11 One is this morning we heard do engagement
12 meetings, future topics touching on competition. All
13 I know is from reading the newspaper, no? But how
14 systematic is that? Well, academics won't deliver the
15 answer. We heard, well, we want to know what the
16 chain is from executive incentives to the price-
17 setting within firms. I think that's a fascinating
18 question, and it is an open question, but academics
19 are not going to answer that question. We don't have
20 the data, okay? So the regulators need to think about
21 how badly they want to know the answer to these
22 questions.
23 Okay, so I've always held back with policy
24 proposals or endorsing them, but I do want to speak
25 about a few arguments that I think are not warranted

1 in this and just miss the mark. And one of them is
2 that any intervention would be all radical and new and
3 based on brand new theories. I don't think that’s
4 true.
5 Regulators understood long before this
6 literature started about this problem. In the 1934
7 Senate Securities Report -- again, Commissioner
8 Jackson mentioned it this morning -- it reads,
9 “Congress must ‘prevent the diversion of these trusts
10 from their normal channels of diversified investment
11 to the abnormal avenues of control of industry.’” In
12 the SEC’s -- that's a typo, ICA, Investment Company
13 Act, bill -- reads, “and the national public interest
14 is adversely affected when investment companies have
15 great size and excessive influence on the national
16 economy.”
17 And ICA as written, it applies to funds but
18 not the management companies, which pointed Jack Bogle
19 earlier this year to point out when and if our index
20 funds get to 10 percent, all we have to do is start a
21 second one and we’d be in technical compliance. We
22 need new limits. And we mentioned Jack Bogle’s piece
23 last September, that he thinks we can no longer ignore
24 the concentration of corporate power that is bundled
25 in the so-called index funds.

1 Okay, so one might ask, but what about the
2 benefits of diversification? Well, that's been
3 partially addressed, and I'll address quickly. The
4 common ownership problem, as presently documented, has
5 very little to do with households' ability to
6 diversify. There might be this problem in the limit,
7 but for the moment, that's not what the problem is.
8 Berkshire Hathaway is not an index fund. ValueAct is
9 not an index fund. So there are many things one can
10 do before even starting to think about touching index
11 funds. Although that might be the logical conclusion,
12 I don't think I have time to talk about the more
13 minutia down here.
14 Second is common ownership reduces
15 incentives to compete and potentially welfare
16 because of the reduced cost of diversification they
17 enable. And this is an excerpt from Rotemberg, who
18 says, "government interventions which reduce
19 diversification ... are potentially beneficial since
20 they promote competition." So everybody is aware that
21 mutual funds help reduce the cost of diversification,
22 but that might be the fundamental problem behind it
23 all.
24 So I'm very glad that the SEC and the FTC
25 talk to each about this because they have different

1 missions here. And the investors currently are caught
2 in between this conflict, which has been in the room
3 the entire day, but that is what the conflict is.
4 It’s not like, oh, but they help diversify investments
5 and, therefore, we shouldn’t do anything about it.
6 This is the basic problem, okay?
7 Now, I'll conclude by Rotemberg’s
8 conclusion, who literally points to mutual funds and
9 says by lowering the cost of diversification, they
10 naturally induce more collusion -- he means collusive
11 outcomes -- if managers follow the wishes of the
12 ultimate recipients of the dividends. It may well be
13 that the funds which concentrate on specific
14 industries, and those whose portfolio is very broad,
15 do the most harm.
16 Okay, so that is just opening a debate,
17 indeed, as we’ve pointed out on where we want to draw
18 the lines between do we want firms to act in the
19 owners' interest and to which extent do we want the
20 owners to be diversified in unrestricted ways. And I
21 don’t want to chime on what correct tradeoff here is,
22 but that's what the debate is and what it should be
23 about. Thank you.
24 (Applause.)
25 MR. ADKINSON: Thank you, Martin.

1 And we're going to take a short, ten-minute
2 break. Please be back quickly because we have a lot
3 to do this afternoon.
4 (Recess.)
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1 **THEORIES OF COMPETITIVE HARM FROM COMMON OWNERSHIP**
2 MR. ADKINSON: We’re now going to convene
3 the second panel for this hearing. It’s Theories of
4 Competitive Harm from Common Ownership. I’ll briefly
5 introduce our distinguished panel. Starting from the
6 far end, I believe it’s Bill Rooney down there, Co-
7 Chair of the Antitrust and Competition Practice Group
8 at Wilke Farr & Gallagher.
9 Then it's Fiona Scott Morton, who is a
10 Professor at the Yale University School of Management.
11 And then Professor Einer Elhauge at the Harvard
12 University Law School; Professor Menesh Patel,
13 University of California, Davis, School of Law;
14 Professor Scott Hemphill, New York University School
15 of Law; and Professor Dan Rubinfeld is my comoderator
16 at the New York University School of Law.
17 MR. RUBINFELD: Thanks, Bill. We're going
18 to really get down in the weeds this afternoon and
19 talk some serious economics and law at a different
20 level than we did this morning. And my hope for the
21 session is that the commentators we're going to hear
22 from will help us to understand some of the possible
23 if not plausible or perhaps likely mechanisms by which
24 common ownership may create a competition problem.
25 And those could range from what we in antitrust call

1 unilateral effects; they could be coordinated effects;
2 they could involve different kinds of communications,
3 either through the board, through earnings calls,
4 through private or public talk of other kinds.
5 They could involve forms of remuneration.
6 They could involve proxy voting, and I'm sure I left
7 out some other possible venues, but more importantly
8 or equally importantly as Martin suggested in his
9 talk, it could be that there is no form of
10 communication of any kind, nothing that would amount
11 to an agreement or nothing that would amount to
12 necessarily a traditional competition problem, but the
13 structure could create an effect which might warrant a
14 policy intervention.
15 So what I'd like to do is we're going to
16 have each of the commentators talk for at most a
17 relatively short period of time outlining their views
18 on this issue. And then we'll go back to the
19 panelists and discuss two issues. One is to get some
20 criticism or clarification as how they think -- if
21 there is a competition problem, how they think it
22 might arise.
23 And given what I just said, the final issue
24 I want to talk about is whether antitrust is really
25 the appropriate remedy because there are some

1 potential structural problems that might suggest
2 policy intervention but would not necessarily invoke
3 either Section 1 of the Sherman Act or Section 7 of
4 the Clayton Act.
5 So with that overview, I'll warn everyone
6 I'm going to jump in if you go beyond your allotted
7 time and interrupt you at will. Otherwise, I look
8 forward to a great conversation and maybe a little
9 debate along the way.
10 So we'll start to my left with Scott
11 Hemphill.
12 MR. HEMPHILL: Great. So thanks again for
13 the opportunity to talk about this, I think,
14 fascinating and important issue. And thanks again to
15 the FTC for choosing to do this at NYU. So, today,
16 I'd like to talk about some research I've been doing
17 with Marcel Kahan, a colleague here at NYU. The title
18 of our paper is "The Strategies of Anticompetitive
19 Common Ownership."
20 Now, this is the same paper that you all
21 heard about at some length this morning from
22 Commissioner Phillips and also from Commissioner
23 Jackson. The full paper is available on SSRN if you
24 want even more after getting through today. The link
25 is listed on the slide, but in any event, let me offer

1 a few introductory thoughts about the project.
2 So the project is to identify and examine
3 the causal mechanisms that might link common ownership
4 to higher prices and then bring that thinking to the
5 empirical evidence that's been developed thus far.
6 We're particularly interested in empirical studies and
7 theoretical work that use a particular measure, the
8 MHHI, which you heard about a little while ago. This
9 is the measure developed in O’Brien and Salop and also
10 in some earlier work by Tim Bresnahan and Salop that's
11 been used to measure common ownership and is quite
12 prominent in the literature.
13 For each of these strategies, we try to
14 answer two questions. First, to what extent is it
15 tested by the empirical literature? Second, is it
16 plausible? That is, would such a strategy be
17 effective if attempted, feasible to implement, and in
18 an investor’s interest, given the benefits and
19 offsetting costs.
20 Our basic message is that some mechanisms
21 are tested and some mechanisms are plausible and that
22 the intersection between those two mechanisms that
23 have both been tested by the existing literature and
24 are plausible is relatively few. And then we describe
25 some implications for assessing welfare, for reform,

1 and for further investigation.
2 Now, in thinking about any given mechanism,
3 there are three basic questions we think we should
4 answer. The first is conflict. Would a noncommon
5 owner at the firm oppose the common owner strategy or
6 is it happy to go along? The second question is about
7 what I'm putting here as precision. Does the
8 mechanism target a particular firm action such as
9 capacity on a particular route in the airlines
10 context, or does it instead alter incentives across
11 the board, perhaps weakening overall a manager's
12 incentive to compete or, indeed, to maximize profits?
13 Third is the distinction that Commissioner
14 Phillips emphasized this morning between active and
15 passive strategies. Does the common owner take
16 affirmative actions to push the common owner to do
17 something, or is it really about, you know, sitting
18 tight, thereby permitting the firm to relax and
19 compete less?
20 Now, there's a lot more in the paper than
21 what I'm going to get across in what's left of my
22 seven minutes, but we make three main points. First,
23 the empirical program that's based on MHHI -- not the
24 entirety of the empirical evidence, mind you, but I
25 think the most important part thus far depends on a

1 conflict of interest between the common owner and
2 other investors. So to take an example, if an owner
3 of just one airline is happy to go along with the
4 common owner strategy, right, when the owner owns just
5 one airline, they're happy to go along, then this
6 strategy is not well tested by the MHHI approach.
7 Second, for strategies that are passive
8 across the board, you know, so and help the firm live
9 the quiet life, most of these are not tested and most
10 are not plausible.
11 And, then, finally, third, as to active
12 targeted strategies, right, imagine an investor
13 telling the firm, you better go, you know, reduce
14 capacity on a particular route, that these aren't
15 plausible for institutional investors.
16 So let me just offer a few thoughts about
17 this first point about MHHI, right, as we've heard the
18 most important tool used thus far in investigating
19 common ownership, I would say both on the theory side,
20 right, the O'Brien/Salop story has MHHI at its
21 foundation, and also the airline study and other
22 empirical work.
23 The key thing to see here is that when
24 common ownership goes up, MHHI increases. Well, no
25 duh, right? That's exactly what you would expect for

1 any reasonable manager of common ownership, but
2 importantly, MHHI decreases when there is an
3 additional noncommon investor. And to be clear, this
4 is not just a question of replacing or displacing an
5 existing common owner. What we're talking about here
6 is conditional on some level of common ownership, if
7 you added a noncommon owner, MHHI would go down.
8 Now, why did that make any sense as the
9 basis for a model? Well, it comes out of an
10 underlying story where there's conflict back and
11 forth, disagreement between the common owner and the
12 noncommon owner.
13 This is what Dan was talking about before as
14 divergent interests. This divergent interest point is
15 really important because not all mechanisms that we
16 talk about have this conflict. So take an example
17 where some common owner tells American and United, it
18 would really be in your interest to reduce capacity or
19 to increase price. Maybe you already knew this, maybe
20 not, but in any event, it’s in everybody's interest to
21 do this.
22 If you regard that mechanism as a plausible
23 one, I think it’s important to recognize it’s not an
24 MHHI kind of story. Now, could a common owner have a
25 special ability compared to other investors to promote

1 a strategy like that? Well, maybe, but the MHHI-based
2 literature is not informative about this point.
3 Do I have another minute?
4 MR. RUBINFELD: Yes, you do.
5 MR. HEMPHILL: All right. So I thought I
6 had about another minute. I just wanted to make sure.
7 MR. RUBINFELD: And we have not colluded on
8 this, right?
9 MR. HEMPHILL: Okay. I see you're pulling
10 the one-minute hook. Yeah, there we go, one minute,
11 great.
12 So one other comment about passive
13 mechanisms, and that's that MHHI is not a great fit
14 for studying passive mechanisms either. Well, why is
15 that? Well, MHHI doesn't actually measure passivity.
16 That wasn't the point, right? So, for example, if two
17 index funds merge, right, imagine each of them is
18 passive. Together, still passive, but not more
19 passive, or at least not necessarily more passive, and
20 your MHHI goes up in that circumstance.
21 Or take maybe the basic fact in this economy
22 of, you know, dispersed retail investors being
23 replaced by passive -- we might imagine -- passive
24 index funds. Well, there, too, here we have a
25 situation where dispersed retail investors were

1 passive and index funds on this story are passive,
2 too, so there's no real change in passivity, and yet
3 MHHI goes up. So MHHI is capturing or is failing to
4 capture passivity, and so it’s not the right measure
5 for testing that kind of a theory.
6 MR. RUBINFELD: Thank you very much, Scott.
7 Our next speaker, moving down the aisle,
8 will be Menesh. Thank you.
9 MR. PATEL: Great. Thanks, Scott. I
10 learned a lot from that talk and also from your paper
11 with Marcel. My comments are also based on a paper
12 that's in the Antitrust Law Journal, so I'll keep my
13 comments at a fairly high level. The issue of common
14 ownership is a complex one, but in many regards, it is
15 not a complex issue. And the reason for that is that
16 the common ownership issue relates to some of the very
17 fundamental precepts of antitrust that we as antitrust
18 scholars, practitioners, and regulators think about on
19 a daily basis when we consider issues in antitrust,
20 counsel our clients, litigate cases, and shape
21 antitrust policy and enforce the antitrust laws.
22 And, so, what I explore in my work and the
23 comments that I’d like to address briefly today
24 postulate that when these core principles of antitrust
25 are applied to the common ownership question, the

1 answer that is the outgrowth of that is an eminently
2 antitrust answer. And the antitrust answer is that it
3 depends. While common ownership may in certain
4 instances give rise to substantial competitive
5 effects, in other instances, it may not. And the
6 answer to that question depends on things such as the
7 structure of the market, the objectives, and
8 incentives of the participants that are in those
9 markets.

10 Just because the common ownership question
11 is so factually dependent doesn't mean that we throw
12 up our arms and go home or I suppose live the quiet
13 life as we read in the literature. Instead, our
14 objective is to critically evaluate and identify those
15 salient features that cause common ownership to have a
16 substantial competitive effect and see in a given
17 market whether or not those factors are present or not
18 present.

19 That mode of analysis should sound quite
20 familiar because it indeed is the same analysis that
21 we use when we evaluate whether or not a particular
22 merger generates substantial competitive effects. And
23 that is not by coincidence. The same competitive
24 concerns that underlie mergers, underlie issues of
25 common ownership. Indeed, as Dan has reminded us, a

1 merger is a very special case of a common ownership,
2 and just like many mergers may raise no substantial
3 competitive concerns. That, too, is the case for
4 instances of common ownership.
5 That basic proposition that is that common
6 ownership may be competitively benign in many
7 circumstances is a very simple proposition that I
8 think generates some modest yet important implications
9 for the shape of antitrust policy.
10 Before getting into those factors that may
11 not cause common ownership to have deleterious
12 competitive effects, it's worth it to explore
13 circumstances in which they may. And we need not go
14 too far. We can consider the workhorse model of
15 common ownership that undergirds so much of the
16 empirical work and theoretical work in this area, and
17 that's the model by Dan and Steve Salop that Dan
18 discussed earlier.
19 It is an economic model, and like all
20 economic models, it is built upon a set of core
21 precepts, assumptions that are intended to model a
22 particular market environment. It's worth marching
23 through quickly some of those key economic
24 assumptions.
25 First, the model assumes that the firms in

1 the market under consideration produce homogenous
2 products and engage in Cournot competition. Second,
3 the model postulates that owners of those firms
4 simultaneously have ownership interests in other firms
5 in the relevant market, i.e., common ownership.
6 Third, the model assumes that the managers
7 of each of their firms set their output in order to
8 maximize a weighted portfolio of each of the owners'
9 portfolios, and keeping in mind that each shareholder
10 has ownership interests across other firms in their
11 relevant market.
12 And, fourth, the model assumes that there is
13 no market entry or at least there's no entry at the
14 equilibrium. And, finally, to keep the model
15 tractable, it assumes that there are no other markets
16 that are affected by the common ownership -- upstream,
17 downstream, complementary markets. Those are assumed
18 away to make the model tractable.
19 It’s an elegant model that generates a very
20 clean theoretical prediction that common ownership
21 results in competitive harm. Why? Well, because
22 managers in the model recognize that if they decrease
23 the amount of competition, yes, that decreases the
24 amount of profits that accrue to that firm and that
25 firm's shareholders, but some of those profits are

1 regained by competing firms which are then returned
2 back to the firm common owners.
3 In other words, the model creates a linkage
4 between profits of firms across the industry,
5 therefore providing incentives for firms to compete
6 less. The O'Brien/Salop model does a lot more. It
7 also through the model mathematically generates the
8 two key concentration measures that are used in the
9 empirical work and the theoretical work: the MHHI
10 delta, which is a reflection of the amount of common
11 ownership in the market, and the MHHI, which is the
12 sum of the HHI and the MHHI delta, in other words, a
13 modified concentration measure used when there is
14 common ownership.
15 Furthermore, within the confines of the
16 O'Brien/Salop model, and that proviso is important,
17 the MHHI does something more than being just a measure
18 of market concentration. Just like the HHI in certain
19 markets becomes a reflection of competitive harm, in
20 the O'Brien model, the MHHI also becomes a reflection
21 of competitive harm.
22 O'Brien and Salop do not suggest or even
23 intimate that their model applies in all
24 circumstances. Instead, the model applies under those
25 particular circumstances that are assumed in the

1 model. And the key point is many markets -- many,
2 many markets -- may not exhibit those key attributes.
3 And if those attributes are toggled, then common
4 ownership may not result in competitive harm and, in
5 fact, may result in competitive harm that is not very
6 well captured by the modified concentration measures.
7 There are many of those characteristics, and
8 I don't have time to march through all of those, but
9 one can consider even the most fundamental precepts
10 that are embedded in that market. And I'll come back
11 to a few of those later in the time that I have.
12 Consider market entry, for instance. It is
13 undeniably the case that markets differ with the
14 extent of entry that is feasible, both by new entrants
15 or the amount of expansion that current firms can
16 undertake. In the presence of market entry, common
17 ownership’s competitive effects will be substantially
18 muted, if at all. And, in fact, the amount of
19 competitive harm will not be reflected by the modified
20 measures of concentration if there is market entry.
21 MR. RUBINFELD: And, actually, I’ve got to
22 cut you off. Can you just finish up?
23 MR. PATEL: For sure, for sure. The point
24 is quite simple, and the point is that common
25 ownership depends on a myriad set of market

1 characteristics, some of which may be present and some
2 of which may not be present. And our objective is to
3 only target those instances where those salient
4 characteristics may be present.
5 MR. RUBINFELD: Thank you very much.
6 Our next speaker, moving down the line is
7 Einer Elhauge. Einer?
8 MR. ELHAUGE: Thank you all. Thanks for
9 having me here. So I thought a lot of the discussion
10 this morning proceeded on a mistaken premise, with the
11 position of critics of horizontal shareholding like
12 myself have as our position. The assumption was that
13 we want institutional investors to do less. That is
14 not at all the case. The idea is instead that if you
15 eliminate anticompetitive uses of horizontal
16 shareholding in concentrated markets, that
17 institutional investors will use their influence then
18 only to increase corporate performance rather than to
19 have anticompetitive effects.
20 In fact, if you have less horizontal
21 shareholding, the natural effect is that institutional
22 investors will have more -- higher levels of
23 shareholding in individual companies and thus have
24 more incentive to exert influence over them in
25 positive ways, so there is no necessary tradeoff

1 between having institutional investors exert positive
2 forms of influence and eliminating anticompetitive
3 effects.
4 The notion that horizontal shareholding
5 might have anticompetitive effects is not just
6 inferred from theory or models. It's a hypothesis
7 that's been empirically tested. And I want to give a
8 sense of the landscape because it’s a lot broader than
9 just the airline study we hear a lot about.
10 First, there is a very broad cross-industry
11 study that shows that the gap between corporate
12 investment and profits increases with horizontal
13 shareholding levels. That study has been undisputed.
14 There's another study that we did talk about earlier
15 that says that changes in executive wealth make --
16 sorry, that increased horizontal shareholding makes
17 changes in executive wealth less sensitive to
18 corporate performance. That study is also undisputed.
19 Now, critics often focus on an earlier
20 dispute about effects on executive annual pay, but
21 that was just 22 percent that the executive wealth
22 changes. There’s two other undisputed studies that
23 show that increased horizontal shareholding delays and
24 prevents pharmaceutical entry.
25 And, next, there’s a study that shows that

1 horizontal shareholding adversely impacts bank fees
2 and rates. And this is, I think, sort of but not
3 really a dispute. There is a supposedly contrary
4 study that finds mixed results, but it itself says its
5 results are preliminary because it has data problems
6 that they haven't investigated yet.
7 Last, we get to the airline study and one
8 thing that seems to be underappreciated is that even
9 the critics actually replicated the results of that
10 study using their own construction of the data and
11 their own definition of horizontal shareholding. They
12 changed the results only by changing the regression in
13 various ways that I would argue are incorrect, and I'm
14 going to talk about one not here in the slide but this
15 morning it was brought up that bankruptcy can affect
16 airlines, and I think that's right. The trouble is
17 that in bankruptcy you're not sure exactly how much
18 weight to give the shareholders because after
19 bankruptcy they generally retain some level of
20 shareholding in the firm.
21 So what the study did, though, is it ran the
22 study again, excluding periods of bankruptcy, and what
23 it found is that removing that confounding effect
24 actually increased the price effect.
25 All right, so what are the causal

1 mechanisms? I don't think they're either surprising
2 or mysterious. They are the same exact causal
3 mechanisms that law and economics for decades has been
4 citing as the explanation for how the separation of
5 ownership from control gets restrained and how agency
6 slack gets limited. And if you think those mechanisms
7 can change corporate operations in a way that
8 increases corporate performance in good ways, it
9 follows they can also change corporate operations in
10 ways that might increase corporate profits in
11 anticompetitive ways.
12 One obvious one is board elections. Now,
13 the arguments against it -- I think the best argument
14 against this is, oh, but a lot of elections are
15 uncontested. Well, we’ve got empirical evidence that
16 shows that the share of votes withheld, even in
17 uncontested elections, has a strong effect on whether
18 the directors keep their jobs and whether they lose
19 committee seats.
20 Then there’s executive compensation, and we
21 just saw how that can be structured to reduce
22 competition. The big complaint about the causal
23 mechanism here has been, well, sometimes these votes
24 by shareholders are nonbinding. Well, okay, but the
25 empirical literature shows that even in nonbinding

1 votes, the votes that are withheld, have a very strong
2 effect on reducing CEO pay. There's a market for
3 corporate control, labor markets, direct
4 communication, other mechanisms as well. Now, one
5 distinction that Scott has drawn in his excellent
6 paper is between macro-mechanisms and micro-
7 mechanisms, and macro-mechanisms being one that
8 influences general corporate competitiveness, micro on
9 particular markets.
10 But I don’t think it’s the case that the
11 macro ones have not been tested. In fact, the airline
12 study itself separated out the airline-wide effect on
13 competitiveness from route effectiveness, and 90
14 percent of it was macro effect on general
15 competitiveness. And the cross-industry studies also
16 find the general effect.
17 In terms of micro effects, we have it proven
18 empirically in airlines, banking, two pharmaceutical
19 studies, and evidence by these earnings calls. Then
20 what about these contra-mechanisms people talk about?
21 One is, well, there’s nonhorizontal shareholders, and
22 they’ll have conflicting interests. Those are
23 actually already included in the formulas and the
24 models, but the key thing for them is they benefit
25 from horizontal shareholding because horizontal

1 shareholding does not reduce competition from that one
2 firm unilaterally. Horizontal shareholding reduces
3 competition from their firm and their rivals
4 simultaneously.
5 So a nonhorizontal shareholder has no more
6 incentive to object to horizontal shareholding than
7 they would to object if the firm could enter into a
8 legally permitted cartel. That's different from
9 saying we're going to restrict ourselves; we're going
10 to instead enter into something that helps us produce
11 competition across the board.
12 The other argument raised has to do with
13 vertical shareholding. For example, the claim that
14 the S&P 500 wouldn't allow anticompetitive effects
15 because, after all, they own business travelers in the
16 airlines as well. Well, if you look at the actual
17 incidence, though, of these increased prices, you find
18 that 95 percent of the price increase is inflicted on
19 people outside the S&P 500 because there's a lot of
20 nonbusiness travelers and a lot of the business
21 travelers aren't in the S&P 500.
22 Finally, there's been a claim that index
23 funds lack incentives to increase portfolio value. In
24 fact, I think they've got plenty of incentives, in
25 part because the costs are either zero or negative.

1 You have to vote one way or the other on the board or
2 on the executive compensation. And, in fact, it’s
3 kind of negative because the less you annoy
4 management, the better are they likely to treat you.
5 They have incentives to get flow. And really all that
6 matters is that they exert more effort than other
7 shareholders.
8 But the key thing, I think, is there's tons
9 of empirical evidence that shows that index funds
10 exert a lot of effort and are hugely influential,
11 including in very positive ways that increase
12 corporate value. So the notion that they are doing
13 nothing is not consistent with the empirical evidence,
14 even outside the horizontal shareholding area.
15 And there's also, as Martin mentioned,
16 there’s 24 studies now that show that common
17 shareholding does have an effect on corporate
18 operations. So at some point, you have to give up on
19 the theory that, oh, it's impossible, they could
20 possibly have it, when we've seen it proven time and
21 time again.
22 MR. RUBINFELD: Thank you, Einer.
23 Fiona Scott Morton is our next speaker.
24 MS. MORTON: Thank you. I wanted to begin
25 with a concern about the design of these hearings. I

1 observed, I wasn't able to attend in person this
2 morning, but I observed that there were many mutual
3 fund industry members here, and it strikes me as a bit
4 odd for the FTC to need to hear from so many people
5 who are interested parties who make money from this
6 industry and are going to say that they would like to
7 keep on making money. I think that it's kind of clear
8 that that would be the message, and I don't really see
9 -- we can have employees of funds, we can have trade
10 associations, we can have consultants, but it's going
11 to be a little bit repetitive. So as a use of time,
12 I’m not sure I understand it.
13 We then have a panel like this one with a
14 bunch of academics on it, but there are three kinds of
15 real research in this area -- economic theory,
16 economic empirical work, and legal analysis. Einer
17 wrote the first legal analysis paper that I know of in
18 this area, and I have a policy paper, but there is
19 nobody else on this panel who has written either a
20 theory or an empirical paper in this area.
21 So if I were going to try to learn about
22 this topic, I would try to find those people. Now, I
23 know there are three of them in the afternoon, but as
24 we've heard, there’s 24 papers. So, again, it's not a
25 super efficient way to gather information.

1 But probably the most interesting omission
2 is that 80 percent of stocks in America are held by
3 the top 10 percent wealthiest people. So the bulk of
4 the -- should this be a problem, okay, the bulk of the
5 harmed people have no representative in these hearings
6 at all, as far as I could tell.
7 So we have some fund industry people saying
8 we'd like to keep our dollar; please don't make a
9 regulation that would take it away. And we have
10 academics saying whatever we think the truth is, but
11 there's nobody on the other side saying, I want that
12 dollar, also, I'm a regular person who buys Coke and
13 Pepsi or airline tickets or whatever I buy, and I
14 would rather have the dollar than have somebody else
15 have the dollar. So I think the representation of the
16 bottom end of the income distribution is a problem.
17 And I noticed this morning that it was
18 represented that the median owner of stocks earns
19 $130,000 a year or something like that. Now, you
20 know, that's two and a half times the median family
21 income. That’s probably considered quite low income
22 if you work in financial services, I understand that.
23 But it's also misleading in the sense that if you take
24 the owners of stocks and you line them up and you pick
25 the middle guy, you get 130,000. But if you line the

1 stocks up from order of low wealth to high wealth,
2 since 80 percent of the stocks are held by the top 10
3 percent of the income distribution, the middle stock,
4 that guy is super rich. I mean, I have not done that
5 experiment. I don't know what that income is, but it
6 would be in the millions for sure.
7 So this problem is not one that is
8 afflicting people in a symmetric way. There's a big
9 difference between people -- the bottom 80 percent of
10 the income distribution who would like prices and the
11 top 20 percent of the income distribution that face a
12 tradeoff between diversification, as Martin clearly
13 said, and prices.
14 Okay. So let me turn to some substance.
15 The basic economics here has been covered very well by
16 others. There's incentive which is profits, money,
17 higher stock prices, higher returns, which I think is
18 a basic function of the asset management industry and
19 ability which is corporate governance, which, again,
20 if we don't have corporate governance we have a big
21 problem with capitalism. We need a way for owners to
22 influence managers to make sure they're working on
23 behalf of the shareholder.
24 But I would combine the incentive and the
25 ability, which is what we traditionally look for in

1 antitrust with size. Okay? This is a very large
2 problem. If there's a problem, it's impacting all of
3 public and private corporations in America because
4 there are so many common owners. And it's a problem
5 we don't understand very well. So if something is a
6 problem you don't understand very well and it's
7 enormous, I think that the conclusion we could all
8 agree to is that we should be studying this quite
9 vigorously.
10 Okay, academics are, in fact, studying this
11 vigorously. The 24 papers, most of them have been
12 written really recently. However, I need to second
13 Martin in saying that academics cannot study private
14 communications. It's not possible. They're secret.
15 So if FTC were to do one useful thing from these
16 hearings, it would be, I think, to open a study, a
17 6(b) study, and go out and get the kind of data that
18 you would need to have to study this problem more
19 seriously.
20 And I think if the financial services
21 industry says we don't want you to study our
22 communications, we don't want you to study this
23 problem, then we have our answer. I mean, if there's
24 something to hide, you don't want a study. If there's
25 nothing to hide, then you don't mind if there's a

1 study. So that will be informative to hear about.
2 Then the last thing I just wanted to touch
3 on was the need for more corporate governance theory.
4 As I said, that would be what I would be trying to get
5 on a panel if I were organizing hearings because we
6 really don't have good models of how it is that
7 ownership translates into product market competition.
8 So we have a bunch of -- Einer very eloquently put a
9 list up, and that makes plenty of sense, and those
10 things are all plausible, but actually if you go out
11 and you look in the literature, those papers have not
12 been written.
13 So I think it would be super helpful if we
14 had some more engagement from the corporate finance
15 community and the theorists to write these things
16 down. I think we're all paying a lot of attention to
17 MHHI, and that has also been said today, a product of
18 a very specific model. And there are many other
19 models out there. And, so, I think beating a dead
20 horse over MHHI, there's no need to do that. There
21 are plenty of other ways in which owners could affect
22 product market competition, and it would be more
23 helpful I think to study some of those.
24 So the one that I think is extremely
25 important to touch on that both Einer and Scott said

1 in different ways and I'll try to meld that together,
2 the distinction between taking my owners and worrying
3 about whether one holds $2 of United and 8 of Delta,
4 and the other one holds eight of Delta and 2 of United
5 -- what did I just say? Two of one and eight of the
6 other. Any way, the reverse. Those two owners are
7 not indifferent to the location of a dollar of profit.
8 The one that holds more Delta wants it to land on
9 Delta, and the one that holds more United wants it to
10 land on United.
11 So that's the sense in which people don't
12 like MHHI. But the obvious alternative model, which
13 Scott raised and Einer raised, is the idea that maybe
14 we soften competition in a way that just leads to
15 generally higher prices. Nobody is against generally
16 higher prices. The owner who owns only Delta thinks
17 it’s great if Delta has higher prices because they're
18 going to earn more money, their stock price is going
19 to go up. There's no sense in which the management of
20 Delta doesn't experience this as a good thing for its
21 fiduciary duty. The stock price of Delta goes up.
22 So I think these directions are ones where
23 we need to take the literature so that we can write
24 them down, be rigorous about testing them, and figure
25 out whether there are other routes besides the MHHI,

1 which seems to be a little overdiscussed relative to
2 the options. Thank you.
3 MR. RUBINFELD: Thanks, Fiona.
4 And, Bill Rooney, you've been relegated --
5 or not relegated, you’ve been added to the list of
6 academics on the panel by Fiona, so, Professor Rooney,
7 you're the last one.
8 MR. ROONEY: Thank you, Dan.
9 Good afternoon, Commissioners Chopra,
10 Phillips, and Jackson and my good colleagues. Thank
11 you to the FTC and NYU for inviting me to participate.
12 It is really a privilege and a pleasure. Like others,
13 I speak only in my personal capacity, not on behalf of
14 my firm or any client, and although I am a practicing
15 lawyer, I'm not giving legal advice this afternoon.
16 I will address common ownership from a
17 specifically legal standpoint, and I will assume that
18 Section 7 of the Clayton Act may apply. I do not
19 address the issues of long-held investor positions or
20 the statute of limitations.
21 I start with basic due process. We are
22 accountable only for our own actions. Liability is
23 personal. We are not accountable for the actions of
24 others whose conduct we have not caused and with whom
25 we have not joined in concert and for whom we are not

1 legally responsible. That proposition and Section 7
2 law present a steep hill for those wishing to hold a
3 common investor liable, even if by awful assumption,
4 managers choose to lessen competition.
5 My question: whether an investor stock
6 acquisition of 10 percent or less of an issuer could
7 violate Section 7 where the investor owns not more
8 than 10 percent of a competing issue or stock and is
9 not competitively related -- horizontally or
10 vertically -- to either issuer.
11 A few more assumptions. The shareholding
12 does not provide the investor with the rights to
13 direct the affairs of either issuer, receive
14 competitively sensitive information, appoint
15 directors, or participate formally in governance. I
16 do not speak today to the effect of altering any of
17 those assumptions. They are meant to distill and
18 engage the question of whether common ownership qua
19 common ownership plausibly subjects the investor to
20 Section 7 liability.
21 Finally, I assume that the share acquisition
22 provides the investor with access to management of
23 both issuers, though not the ability to control or
24 coerce their decision-making.
25 I first note the relevance of Section 7's

1 investment-only exemption. The exemption states in
2 substance, Section 7 shall not apply to persons
3 purchasing stock solely for investment and not using
4 the same by voting or otherwise to bring about the
5 substantial lessening of competition. Many common
6 owners are institutional investors, and their share
7 purchases, on the parameters that I have set, would
8 likely be solely for investment and presumptively
9 exempt from the Clayton Act.
10 The plaintiff would then have to displace
11 the exemption by showing that the shareholder has
12 used its stock to cause a substantial lessening of
13 competition.
14 Three observations. First, displacing the
15 exemption requires the shareholder to have used, not
16 just held, the shares; to have caused, not just
17 threatened, an actual, not just probable, substantial
18 lessening of competition. Second, not all voting
19 takes the investor out of the exemption, just voting
20 that causes the substantial lessening of competition.
21 Third, the voting would have to relate proximately
22 to competition, not to governance or many other
23 noncompetitive issues. Although facts always matter,
24 most executive packages would seem insufficiently
25 related to competition to void the exemption.

1 Although I will not address here whether a
2 shareholder's engaging with management is inconsistent
3 with Section 7's exemption, the case of *Tracinda* held
4 that it was not. The exemption thus provides common
5 ownership with substantial protection. So does
6 Section 7 jurisprudence. Section 7 requires the share
7 acquisition to provide the shareholder with a
8 mechanism to lessen competition substantially, and the
9 substantial lessening must be probable, not possible.
10 Not just possible. All elements, of course, are
11 necessary.
12 If the shareholder acquires its common
13 investment and does nothing, and even if the issuers,
14 again by awful assumption, respond to the common
15 ownership by reducing competition, the shareholder is
16 not liable. Recall our due process starting points.
17 Legal liability cannot obtain from a lawful act --
18 here are the acquisition of shares -- in response to
19 which others, by assumption and by themselves, act
20 unlawfully.
21 Nor does an assumed incentive constitute
22 causation. Suppose Noncompetitor A, a known premium
23 pricer, buys a Company B, a price cutter, and raises
24 B's prices. Competitors C and D conclude the coast is
25 now clear to raise their prices, and they do. Company

1 A is not liable under Section 7.
2 Cross ownership differs from common
3 ownership. In cross ownership, Competitor A acquires
4 an ownership interest, typically greater than 10
5 percent, in Competitor B, or perhaps in a customer or
6 a supplier. Competitor A, by its own conduct, can
7 lessen competition with Competitor B to protect its B
8 shares. Competitor A can also favor the acquired
9 supplier or buyer.
10 The cross owner, unlike the common owner,
11 participates in and therefore can affect competition
12 in the relevant market. But could the owners' access
13 to management provide the mechanism that establishes
14 the necessary probability that the common owner will
15 join the issuers in substantially lessening
16 competition? The answer is no.
17 Access alone, or shareholder engagement, is
18 competitively neutral, has been encouraged by the SEC
19 in Congress, and has many confirmed benefits. One can
20 speculate whether or when a common owner may try to
21 lessen competition between or even among issuers, but
22 that conduct would entail legal risk and, given the
23 many lawful and beneficial uses of access, the
24 prospect remains speculative, at most a possibility,
25 not a probability, and cannot support Section 7

1 liability.

2 MR. RUBINFELD: Thanks, Bill.

3 To summarize briefly, I think what we've

4 heard and what we're going to continue to talk about,

5 we might think of the issues that are raised as

6 consisting of three categories of issues. First of

7 all, arguments based partly on the discussion of the

8 MHHI, that there is a possibility, if not a

9 probability, of adverse unilateral effects.

10 Second, the possibility through sharing of

11 information or communications of one kind or another,

12 there's a possibility of coordinated effects.

13 And third, just because the inherent

14 structure of the industry and the extent to which

15 there is common ownership, the implicit argument or

16 explicit, in some cases, is that firms maximizing

17 their profitability, their shareholders' interest,

18 might act differently if there's extensive common

19 ownership than if there's not.

20 Now, if I can just quickly advertise, Ed

21 Rock and I have been working on this issue. Our first

22 paper I saw as being primarily about unilateral

23 effects with some commentary on the second or third

24 alternatives that I mentioned. We have a new paper

25 which we just put on SSRN yesterday which talks about

1 possible coordinated effects. And perhaps if we keep
2 working on this issue, we'll think about the broader
3 structural issues.
4 Now, the comments we've heard from the panel
5 really cover that range, and I'd like, if possible,
6 during this round to give each person a chance to
7 respond to each others' comments or to expand on what
8 they're saying, but I'm particularly interested in
9 what your views are as to what the likely mechanism or
10 plausible mechanism is.
11 For example, Einer, you've listed a whole
12 list. I'd like to pin you down a bit on what your
13 favorite is and, also, the issue which we'll talk
14 about next will be whether we think there's really a
15 competition problem that for which the FTC should be
16 worried or whether there's more of a broad structural
17 problem. But let's focus right now on the mechanism.
18 So, Scott, I'll just go down the line. Do
19 you have any comments about what you've heard from the
20 other commentators, or do you want to expand on your
21 own views about the likely mechanism, if there is one?
22 MR. HEMPHILL: Yes. It's tempting to take
23 the bait on the first option, but I think I'll go with
24 the second and just plow ahead a little bit on a
25 couple of things I was planning to try to get across

1 this time around.

2 I'd like to make two basic points. One,
3 thinking about the incentives of fund managers, we've
4 already talked about that to some degree -- it
5 surfaced also in Dan O'Brien's earlier comments --
6 and, then, you know, if there's time talk a little bit
7 about a mechanism that I think hasn't gotten enough
8 attention.

9 Now, I think this world, this debate, lots
10 of debates can be sort of divided into folks who want
11 to do a lot of lumping and folks who want to do a lot
12 of splitting. And the way that I've conceived this,
13 you can probably tell, at least in this project, we're
14 very much in the splitters camp, right? We're firmly
15 splitters here.

16 So, you know, I don't think -- you know, I
17 learned a lot from Professor Schmalz's remarks. I
18 don't think a Berkshire Hathaway board seat on a bank
19 helps me that much to understand what's going on at
20 Fidelity, that is, you know, there could be things
21 going on at Berkshire, there could be things going on
22 at Fidelity, but I would be hesitant before saying
23 that what's going on over here helped us necessarily
24 understand what's happening over there.

25 And, so, I want just to dig in a little more

1 on a version of Dan's -- I think it was the third
2 warning label about owner objectives diverging from
3 investment returns. So just a couple of quick points
4 here. One, Fidelity, like Congress, is a “they,” not
5 an “it.” Individual fund managers are interested
6 typically in the returns of their fund, not those of
7 Fidelity as a whole. This, I think, is not a novel
8 point to express but worth putting across because I
9 think it makes it problematic to think about the
10 institutional investor as an undifferentiated whole.
11 Second, for an institutional investor,
12 you're increasing portfolio value, and I recognize
13 there's some difference of opinion on the panel about
14 this, only has a small effect on fees. This bears
15 principally on thinking about active mechanisms as
16 opposed to passive, right, where you're actually doing
17 something, you're doing something that might be
18 costly, you're doing something that might incur
19 liability or reputational harm.
20 And, you know, we got to keep our eye on the
21 ball here that, you know, asset-weighted average fees
22 for equity index funds, I have here it was, like, nine
23 basis points. And for actively managed funds, it’s,
24 like 82 basis points. So we got to think about, you
25 know, what the returns are, at least for the

1 strategies that we might regard as being costly --
2 costly in a legal sense, costly in, you know, its
3 appearance in the *Wall Street Journal*. Internal
4 discussions at Fidelity, you know, that were driving
5 decisions or omissions could be, in a reputational
6 sense, quite costly to the firm. So one message here
7 is that there’s a big difference between thinking
8 about an institutional investor on the one hand and
9 Warren Buffett on the other.
10 You know, there are some technical points
11 here that I'm not going to dwell on, but they’re in
12 the paper. You know, depending on the distribution of
13 holdings across funds earning different fees, an
14 increase in portfolio value can actually reduce fees.
15 So there are some extreme versions of that third
16 warning label to think about, again particularly with
17 active strategies.
18 Another point on incentives that I think is
19 worth making is with respect to passive strategies.
20 You know, let’s think about passive as a strategy for
21 a minute as opposed to just a kind of thing that
22 happens because big funds aren't paying attention,
23 let’s imagine. Right, if as a strategy, adopting a
24 passive stance could be really costly, right. You're
25 causing them to not compete in certain ways and

1 improve your portfolio, but that might, you know,
2 throw out the baby with the bath water. It might, at
3 the same time, cause a dampening of competitive
4 incentives that would be a cost viewed by the fund, by
5 the fund family more broadly.
6 Do I have a minute, or do I not?
7 MR. RUBINFELD: Go ahead.
8 MR. HEMPHILL: Okay, so, finally, just a
9 word about a mechanism that I think is worth paying
10 more attention to that we talk about in the paper
11 called -- that we call selective omission. So the
12 idea here is that an investor might pursue just a
13 subset of the possible available strategies, that is
14 pursue just those strategies that both increase firm
15 value and also increase portfolio value while staying
16 silent, omitting to act as to those actions that also
17 increase the invested-in firm's value, but at the
18 expense of portfolio value.
19 So that kind of selective activity, I think,
20 is one that would be consistent -- consistent with the
21 MHHI-based literature that I'm not willing to abandon
22 just yet. I mean, I think it still is a large part of
23 the most important empirical evidence that we have,
24 and our workhorse theory, and I think apart from its
25 testedness is also plausible.

1 MR. RUBINFELD: Thank you.
2 Menesh.
3 MR. PATEL: Thanks. I don't think that, at
4 least any of us on this panel, maybe no one in the
5 room, disputes the proposition that as a theoretical
6 matter common ownership can impair competition. I
7 think our differences relate to what extent we think
8 that the postulates of that model we observe in
9 various markets and to what extent we believe the
10 empirical findings today show a causal connection
11 between common ownership and adverse effects to
12 competition.
13 But I want to sort of think about focusing
14 on Dan's suggestion when we focus on the mechanism, go
15 back to the workhorse model that guides our theory,
16 our intuition, and the empirical findings and think
17 about how likely we believe that those assumptions are
18 going to hold. And the key assumption, again, is that
19 manager, when the manager maximizes the profit of her
20 firm, her objective function, she maximizes a weighted
21 portfolio of all of the shareholders that are invested
22 in the firm.
23 To what extent is that a reasonable
24 assumption? For if that assumption doesn't hold, then
25 common ownership has no effect on competition. One

1 way to think about that is to exploit an equivalency
2 that is shown in the literature that holds that if the
3 postulates of that model are true, then it is as if
4 the manager is maximizing both the profits of her own
5 firm and the profits of all other firms in the
6 industry that are subject to common ownership.
7 Meaning that if there is this linkage between
8 portfolios, then -- and there are two firms, for
9 instance, in the market -- the manager of Firm A is
10 maximizing profits of her firm, Firm A, and some
11 portion of the profits of the rival firm, Firm B.
12 To what extent is that an accurate
13 assumption? We should think about that. First,
14 fiduciary duties. Dan mentioned we've all thought
15 about what seemingly constrain the manager from acting
16 in that manner. To be sure, it is undisputed that the
17 business judgment rule shields managerial decisions,
18 particularly when they relate to core corporate
19 decisions, such as pricing and output decisions. We
20 do not dispute that.
21 However, if one frames the issue as a
22 manager choosing to set her profits and the profits of
23 a rival firm, that seemingly implicates issues not of
24 duty of care, but duty of loyalty that would give a
25 less robust shielding of the business judgment world.

1 MR. RUBINFELD: Thank you.
2 Einer.
3 MR. ELHAUGE: So you asked -- you wanted to
4 pin me down on which is my favorite. So I think
5 that's the wrong way to think about it. I think it is
6 the combination of them. Some of them apply to some
7 investors but not others. For example, the stock
8 market effect where you might dump your stock to show
9 your displeasure with management does not work for
10 index funds. It works for other kinds of investors
11 who are in and out of stock.
12 The market for corporate control, the
13 proposition that managers might be influenced by the
14 fact that they want the shareholder to be on their
15 good side when there's the next control contest, that
16 works better for index funds than for other investors
17 because you know they're going to be around because
18 they have to hold the stock.
19 I also think to some extent that these ways
20 of influencing a company are substitutes for each
21 other in the sense if you clamp down on one,
22 institutional investors would logically put more
23 effort on the other. So, for example, if you try to
24 just legislate the executive compensation and say from
25 now on, we're going to have all stock options with a

1 trigger price that's based on how their industry does
2 rather than just some set price, that might improve
3 things, but then they might switch to other methods of
4 influencing the company.
5 But I'll stress what I think is the most
6 underappreciated, which is the labor market effect,
7 the notion that you might want to please your
8 horizontal shareholders because they are going to be
9 there at the next job. And what's nice that I found
10 in the empirical literature was that there's actual
11 evidence that the percentage of votes that are
12 withheld in elections, even uncontested elections,
13 affect how many directorships you get at other
14 corporations. Right, so it's an influence that's
15 quite direct in that way in terms of trying to please
16 other sorts of companies. So I would say it's the
17 combination.
18 And in terms of the plausibility,
19 intuitively, I think a lot of people feel that the
20 fact that Puerto Rico does not vote in presidential
21 elections might influence the fact that the hurricane
22 response in Puerto Rico was less effective than
23 hurricane response in other states that do vote for
24 the president.
25 Now, do we have a micro-mechanism where in

1 the election the voter said I want -- Mr. President, I
2 want you to focus on this level of hurricane relief --
3 unless there's some operational decisions and
4 communications from voters. No. I think what this
5 shows is who your electorate is and what their
6 interests are, are going to have an influence on
7 operational decisions.
8 You know, so some of the work I do is in
9 political science and law. There, it just seems to be
10 everybody understands it's obvious. It seems to me
11 even more likely to be true here because they have a
12 much bigger share of the votes. Right, the big three
13 vote about a quarter of the votes actually cast
14 because other voters don't vote. Institutional
15 investors vote about 90 percent of the votes cast
16 because other private investors don't tend to vote
17 very much. They get to vote on things besides the
18 elections, they get to have direct communications.
19 They have a lot of other avenues of influence than
20 political voters do. So it seems implausible to me
21 that we would think that they have less influence than
22 political voters do.
23 MR. RUBINFELD: Thank you.
24 Fiona.
25 MS. MORTON: I wanted to respond to one

1 thing that Scott said, which is there's heterogeneity
2 across funds, and that's undoubtedly true, but I do
3 wonder which fund manager it is who is against higher
4 profits. It seems to me that there might be unanimity
5 of enthusiasm for that.
6 In terms of mechanism, I think rather than
7 answer your question directly, Dan, I would say that
8 the mechanism really, really matters for policy here.
9 If it is the case that we were to do studies and find
10 out that the mechanism causing anticompetitive effects
11 was communications between fund managers and top
12 executives, then a policy limiting those
13 communications might be all that was necessary and no
14 change in the way funds run or votes or anything else.
15 If it's voting, as Einer just said, then
16 maybe the policy change needs to address voting. I
17 think that it's super important to dig into this, and,
18 again, I think an FTC study would be the right way to
19 get at this question because without an understanding
20 of the policy and the exact way it works, then if
21 there's a problem, all we can do is use a very blunt
22 instrument. And that seems to be much less ideal for
23 savers and investors than if they're a way of running
24 a mutual fund that did not cause anticompetitive
25 effects. And to do that, we'd have to know a lot more

1 than we know today.
2 So I think this is a really top priority of
3 something to learn more about. I do think -- I do
4 take the point that these methods might be
5 substitutes, if you can't use one you try to use
6 another. But I don't think it's obvious that they are
7 super close substitutes. It might be a lot harder to
8 achieve some kind of outcome with one tool than
9 another. So I just think that's the place to go.
10 MR. RUBINFELD: Thank you.
11 And, Bill, you're last.
12 MR. ROONEY: So I'll stay on the legal side,
13 and I will comment on the need for a mechanism by
14 which a shareholder causes the harm for Section 7
15 liability. And I will focus my comments on two
16 leading cases that seem to be cited in support of
17 common ownership liability. The first case is called
18 *Dairy Farmers*, *U.S. v. Dairy Farmers*. It's a 2005
19 Sixth Circuit case and is often cited with the
20 following quote: "Even without control or influence
21 an acquisition may still lessen competition. The key
22 inquiry is the effect on competition regardless of the
23 cause."
24 And *Dairy Farmers* is often cited for the
25 proposition that the shareholder need not cause the

1 relevant harm. I would say the context clarifies in
2 that holdings can't be divorced from their facts. In
3 *Dairy Farmers*, there were two agreements that were at
4 issue, an original and a revised. The relevant party
5 to both agreements was the Dairy Farmers of America.
6 DFA was the largest dairy farmer cooperative whose
7 purpose was to market the unprocessed milk of its
8 dairy farmer members to milk processors.
9 The parties whose stock DFA acquired were
10 milk processors. So DFA and the processors had a
11 vertical relationship that is not present in common
12 ownership cases. DFA owned 50 percent of one
13 processor called Flav-O-Rich, though did not
14 participate in its management.
15 DFA acquired 50 percent of the competing
16 processor called Southern Belle. Southern Belle and
17 Flav-O-Rich were the only two milk sellers to 42
18 school districts and two of three to 49 districts.
19 The District Court granted summary judgment against
20 the DOJ and the challenge of the acquisition of
21 shares. The Sixth Circuit reversed, remanded for
22 trial, and made no findings as to Section 7 liability.
23 The original agreement gave DFA the right to
24 some control over the business activities of Southern
25 Belle, and so it was a simple case of cross ownership,

1 which we distinguished before.

2 In the revised agreement, DFA exchanged its
3 voting shares in Southern Belle for nonvoting shares
4 but retained its 50 percent financial interests, and
5 recall that the same DFA had a 50 percent financial
6 interest in Flav-O-Rich. The court observed that even
7 under the revised agreement there may be a mechanism
8 that causes anticompetitive behavior other than
9 control. The court found that mechanism in DFA's
10 financial relationship to Southern Bell -- "The
11 government presented evidence that DFA did, in fact,
12 have control or influence over Southern Belle. DFA
13 may leverage its position to Southern Belle's
14 financier to control or influence Southern Belle's
15 decisions. In addition, other business relationships
16 between DFA and operators of Southern Belle and Flav-
17 O-Rich raise the genuine issue of material fact,
18 whether DFA, through its 50 percent interest in the
19 two duopolists, its potential control or influence
20 over one, and its business relationships with both may
21 cause harm to competition."

22 *Dairy Farmers* provides no support in my view
23 for finding a 10 percent common owner vicariously
24 liable for the presumed acts of issuers in which the
25 owner did not participate.

1 *U.S. DuPont* is the second case often cited.
2 It's a 1957 Supreme Court case. And in *DuPont*, the
3 chemical company DuPont owned 23 percent of General
4 Motors stock, was vertically related to GM, and had a
5 close business relationship with GM for 30 years.
6 DuPont supplied over 65 percent of GM's requirements
7 of one relevant product and 35 to 50 percent of
8 another.
9 The court found that DuPont's share
10 acquisition was designed to and did obtain a
11 competitive advantage for DuPont in supplying GM.
12 *DuPont* is a simple case of cross ownership, again at
13 levels in excess of 10 percent.
14 MR. RUBINFELD: Thanks, Bill.
15 For the next round of discussion, we'll
16 continue a bit more on the legal side. We clearly
17 have a difference of opinion between Bill and Einer
18 with respect to Section 7, but I want to broaden the
19 discussion again.
20 It seems to me if we're advising our
21 colleagues at the Federal Trade Commission,
22 particularly the two Commissioners who were here
23 today, we want to distinguish the impact of our
24 discussion as to whether it impacts the way the
25 Commission ought to look at particular acquisitions

1 under Clayton Section 7 or whether they think there
2 should be investigation that might open a look at
3 Clayton -- at Sherman Section 1, or perhaps they might
4 conclude that there's a structural issue here but
5 really no competition issue that requires FTC
6 intervention and maybe they should just talk to their
7 colleagues on the Hill about doing something
8 constructive with respect to the structure and
9 competition in the industry.
10 So I wonder whether -- just going down the
11 line -- whether any of you has any views, just given
12 the work you've done in this area and I would say
13 where you think we ought to really focus on our
14 emphasis as we delve more deeply into these issues.
15 And I was struck in that regard by Martin's
16 comments today. Martin's comments to me seemed to
17 suggest that he thought there was a strong argument
18 for a structural problem but he wasn't making the
19 claim that there's necessarily a violation of the
20 Clayton Act or the Sherman Act.
21 So here's your chance to tell the Commission
22 where they ought to be at least focusing at some of
23 their attention. I'll start with Scott.
24 MR. HEMPHILL: All right. So on the broad
25 question of what is to be done, a couple of thoughts.

1 In my welcome this morning, I invoked Bob Pitofsky as
2 the animating spirit behind these hearings, and I'm
3 reminded of something that Chairman Pitofsky said in
4 thinking about the application of antitrust law to
5 high-tech industries, right. Big issue then as now.
6 He said that as with any adjustment to new
7 facts or proposed law, a cautious approach is called
8 for but abandoning antitrust principles in this
9 growing and increasingly important sector of the
10 economy seems like the wrong direction to go. Now, I
11 think that same kind of caution applies here. I think
12 the right next step, just echoing what a few others
13 have said, but I have maybe a slightly different take,
14 for the antitrust agencies would be to collect more
15 information.
16 This morning, you know, I sort of asked,
17 sort of pled a little bit with Commissioner Phillips
18 and Commissioner Jackson about what they might do to
19 further illuminate this terrain. And I want to echo
20 Martin's comment from before that academics can't
21 observe communications, and in that vein, this might
22 be something that could be looked into.
23 I do want to just kind of note that I think
24 the communications identified so far are a little on
25 the thin side. You know, I'm struck, the example

1 that comes to mind is the airline paper which points
2 to a -- I think it's a Delta earnings call from 2014,
3 maybe it's third quarter, I wouldn't promise, where
4 they planted two analysts who pipe up and ask about
5 reduced -- well, how about some reduced capacity,
6 wouldn't that be good? I forget that they talked
7 about prices as well.
8 Well, one of the analysts was for J.P.
9 Morgan. I'm not sure, though, that this was an
10 analyst for J.P. Morgan’s asset management business,
11 and I assume it was a sell-side analyst that worked
12 with the investment bank. The other analyst who’s
13 also quoted but not named in the study was from Morgan
14 Stanley. And, so, I don't think that communications
15 from sell-side analysts tell us much about the
16 capacity or likelihood of a Fidelity, let's say, to
17 engage in similar communication.
18 Now, partly, this is a point about, this is
19 something we should go run down. I do want to note at
20 the same time that the fact that -- just as we can't
21 observe communications, we also cannot easily observe
22 agency investigations of communications. So, you
23 know, I can't rule out that some of that investigatory
24 work, whether in the airline context or elsewhere,
25 might already have taken place.

1 There's one second area that I think looking
2 into detail might be of some value, which is to think
3 about responsive steps taken by firms. So
4 communications are a no. If firms are implementing
5 strategies, cognizance of who their institutional
6 owners are and what those institutional owners'
7 interests are, then we should observe firms working
8 out that math, right.
9 I'm not saying they have to have an MHHI
10 calculation written down. Oh, okay, I got 12 percent
11 from BlackRock and 12 percent from Fidelity or
12 something like that, but they ought to in some rough
13 sense be thinking, okay, who are my owners, what is it
14 that they want right now, and we should be able to
15 observe, I would think, some of that cognition on the
16 part of the firm. And that's something that could be
17 excavated and either would be present or not, and
18 that, I think, would provide some insight into the
19 nature of the problem, if any, here.
20 MR. RUBINFELD: Thanks, Scott.
21 Menesh.
22 MR. PATEL: Thanks, Dan. I'll keep my
23 comments brief. I suppose three things. First is I,
24 too, would echo the calls for additional research, but
25 I'd also add on the point that the fact that we're all

1 echoing those calls indicates that there is not yet
2 seeming consensus among the community as to the import
3 and the magnitude of this issue. It is not as if we
4 are on the eve of the *Leegin* decision where economic
5 consensus was clear that resale price maintenance can
6 have procompetitive effects and, therefore, be
7 adjudged by the rule of reason.
8 The second is we should be mindful and
9 very careful about using -- in whatever policy
10 prescriptions -- using the modified concentration
11 metrics. Those only serve as guides for competitive
12 harm in certain narrow circumstances. And just as if
13 you are to rewrite the merger guidelines from a blank
14 slate today, we may rely much less on the HHI for the
15 reasons that we all know we want to rely less on the
16 HHI than historically was the case. The same would be
17 the case for that HHI is a noble construct but limited
18 purposefully to its confines.
19 And the third and final piece is we need to
20 be careful and be mindful that efficiencies that we
21 may be butting up against. Our core objective is to
22 make sure that we magnify and amplify the well-being
23 of consumers generally in these markets. The common
24 ownership issue is looking at consumers in the product
25 market, but these very decisions have effects on

1 consumers in other markets with respect to corporate
2 governance changes and also diversification effects.
3 We should be mindful of its consumer interests across
4 the board.
5 MR. RUBINFELD: Thank you.
6 Einer, I was going to pin you down a little
7 bit if it's okay. I know you're going to want to
8 debate *Dairy Farmers* with Bill, but I'm hoping your
9 comments will be a little broader than that because
10 you've thought broadly about a lot of topics. And I'm
11 particularly interested in you elaborating a bit on
12 how you view these solely for investment aspect of
13 Section 7.
14 MR. ELHAUGE: Sure, and I also want to
15 answer your question about -- what did you say? Oh,
16 how traditional merger analysis is going to be
17 affected. So the backdrop is that the Clayton Act
18 does ban any stock acquisition that may substantially
19 tend to lessen competition. And the cases hold that
20 continuing to hold stock itself is an acquisition.
21 So -- and another thing should be brought to
22 mind -- borne in mind is that although it's generally
23 selectively quoted, the statute actually has two
24 provisions. One provision is about commercial
25 enterprises owning stock in other commercial

1 enterprises, but there's a whole other separate
2 provision that repeats it to say it also applies to
3 acquisitions by any entity, commercial or otherwise,
4 in commercial entities. That is -- the structure of
5 the statute also supports the application of
6 horizontal shareholding.
7 Now, the solely-for-investment exception is
8 somewhat of a misnomer. It's really a provision that
9 changes the standard of proof. It provides there's an
10 exemption only if there's both, no influence on the
11 corporation but also that the stock is not actually
12 used to create any anticompetitive effects. So, in
13 effect, all it does is change the standard from may
14 substantially tend to lessen competition to actually
15 doesn't lessen competition.
16 The claim that you need control or influence
17 is not only contrary to that text but there's six
18 cases that interpret it that way. One is the *Dairy*
19 *Farmers* case you mention, and another is the *DuPont*
20 case. It is true that on the facts of those cases
21 there seemed to be influence and control. But that
22 doesn't alter the legal interpretation of that of the
23 actual statute.
24 More to the point, though, the agency
25 guidelines on cross shareholding specifically apply to

1 cases where there's no control or influence, where all
2 you've changed is the incentives of the company. So
3 unless the FTC is going to abandon its merger
4 guidelines on cross shareholdings that only have
5 incentive effects, then it is committed already to the
6 position that the statute is not limited to
7 transactions that create influence or control.
8 Even if the Clayton Act doesn't apply,
9 there's the Sherman Antitrust Act, applies to any
10 agreement in restraint of trade. Stock acquisitions
11 are agreements. If they restrain trade, they apply.
12 In fact, when you look historically, the trusts
13 attacked by antitrust law were horizontal
14 shareholders.
15 As to the proposition that due process
16 would be violated, let me mention three areas of
17 antitrust law that are inconsistent with the theory
18 that you can't possibly be held liable when your
19 anticompetitive effects turn, in part, on the actions
20 of others. One is the *Leegin* case just mentioned,
21 which explicitly stated that resale price maintenance
22 could be legal because it facilitates oligopolistic
23 coordination if others in the industry use the same
24 kind of resale price maintenance -- depending on the
25 actions of others.

1 *Motion Pictures*, for exclusive dealing says
2 you could be liable for the cumulative foreclosure, it
3 depends in part on exclusive dealing of others. And
4 for that matter, mergers to oligopoly are all
5 dependent upon the effects of you interacting with
6 others.
7 Speaking of the traditional merger analysis,
8 let me just say that if we're not going to tackle
9 horizontal shareholding directly, it actually has
10 enormous implications for traditional merger analysis.
11 In particular, it means that we have to lower the
12 concentration level we're willing to tolerate under a
13 traditional merger analysis because we have to take
14 into account that often horizontal shareholding is
15 going to worsen that, in fact that post-merger
16 horizontal shareholding could occur and would not be
17 tackled.
18 I would submit that maybe this is why so
19 many mergers have been allowed that turn out, in fact,
20 to raise prices because the predictions were made
21 assuming no effect. And that's an important feature
22 of current merger analysis. The agency's practice
23 today is not empirically neutral on the effects of
24 horizontal shareholding. It is affirmatively assuming
25 in all their models and HHI measures that horizontal

1 shareholding has zero effect.
2 There is no basis for that assumption. The
3 empirical evidence, I would say, is strongly to the
4 contrary. Certainly, there's no basis for the way the
5 agency is doing its current merger analysis, ignoring
6 horizontal shareholding.
7 Lastly, it actually -- horizontal
8 shareholding also influences which mergers we regard
9 as horizontal as all. Right now, a lot of mergers
10 just fly through as conglomerate mergers, say, because
11 you're merging big, national chains in different
12 geographical markets, not reducing the number of firms
13 in the markets. But often in those transactions we
14 basically moved from having two to five different
15 firms in our local markets to having the same two or
16 five firms in every market. They're all big, national
17 firms with much more horizontal shareholding.
18 So I would say horizontal shareholding
19 actually also support people who are concerned about
20 national concentration levels rising even if HHI
21 levels, standing alone, are not rising in particular
22 geographically defined markets.
23 MR. RUBINFELD: Einer, thank you very much.
24 Fiona.
25 MS. MORTON: Yeah, to follow up on that

1 point, if we were to tighten up merger standards in
2 order to keep markets fragmented, I think that could
3 potentially create significant losses to consumers due
4 to real efficiencies from those mergers. I mean, what
5 we would essentially be saying is we care more about
6 keeping car manufacturers or green bean manufacturing
7 plants inefficient and small so that we can have a
8 concentrated owner downstream for people to invest in,
9 so that tradeoff, seems to me, to be quite asymmetric.
10 I think the cautious approach mentioned
11 earlier is indeed very characteristic of government
12 and appropriate. And, therefore, the evidence that
13 will be required on this issue for the FTC to move
14 strikes me as being significantly more than that
15 required for a well-incentivized private plaintiff to
16 move. And, therefore, my concern is that we end up
17 with disorganized, random private litigation that is,
18 in fact, successful because if there starts to be an
19 evidence body that this, in fact, does cause
20 anticompetitive problems, those plaintiffs may well
21 succeed.
22 Then we have a problem of certain areas of
23 the country. Somebody can't hold Pepsi, and somewhere
24 else, a different fund can't hold Delta, and that
25 seems to me to be a really bad way to run a mutual

1 fund, not that I've ever run a mutual fund myself, but
2 it seems like a bad idea.
3 And not only those different rulings might
4 have ordinal implications. So what do I mean by that?
5 Well, what if the implication on -- what if the
6 evidence showed that to have an anticompetitive effect
7 you have to be the largest shareholder in a company?
8 Well, you might be the largest shareholder today, but
9 another fund might purchase some shares tomorrow and
10 then become the largest shareholder, and then you
11 would perhaps no longer have the same anticompetitive
12 effect you had yesterday. Well, how does that allow
13 for a rational portfolio to be developed because it
14 depends on what other people are doing?
15 So I think the way to solve this competition
16 problem is what I wrote in a paper with Glen Weyl and
17 Eric Posner, and that is to just say hold one of these
18 competitors, and that would solve the competition
19 problem. It would also improve corporate governance
20 because then you would be very much invested in one
21 firm.
22 And the impact, I've done some experiments
23 that I have not published yet, but the impact on
24 variance is small because stocks in the same industry
25 co-move, so holding one does a lot of the job of

1 diversification. The fourth airline doesn't add very
2 much. So I'll stop there.
3 MR. RUBINFELD: Thank you.
4 Bill.
5 MR. ROONEY: So you might find it ironic
6 that an antitrust lawyer would entitle his concluding
7 remarks "The Cost of Antitrust," but there it is. So
8 Judge Easterbrook's influential 1984 article, "The
9 Limits of Antitrust," detail the distortive effects of
10 overenforcement. I offer two quotes for your
11 consideration.
12 "In most cases even a perfectly informed
13 court will have trouble deciding what the optimal
14 long-run structure of the industry is because there is
15 no right balance between cooperation and competition.
16 The judge has no benchmark. Small wonder the history
17 of antitrust is filled with decisions that now seem
18 like blunders."
19 Second, "Donald Turner once described the
20 inhospitality tradition of antitrust. The tradition
21 is that judges view each business practice with
22 suspicion, always wondering how firms are using it to
23 harm consumers. If the defendant cannot convince the
24 judge that its practices are an essential feature of
25 competition, the judge forbids their use."

1 The annals of antitrust law are indeed
2 filled with blunders. Since 1975, all vertical,
3 price, and nonprice restraints have been moved from
4 per se illegality to rule of reason review by
5 overturning Supreme Court precedents. Consider the
6 extraordinary development in merger review and
7 enforcement from the 1950s to the modern era. We've
8 realized that private actors do not always or even
9 frequently have anticompetitive malice in their
10 hearts. Rather, they often favor consumers -- more
11 innovation, lower prices and greater outputs.
12 In the present circumstances, institutional
13 investors have their own consumers to serve. Millions
14 of investing workers, union members, and, yes, main
15 street residents. As I have noted, common owners are,
16 by definition, not active in or adjacent to any
17 relevant market in which a lessening of competition is
18 feared. This is in stark contrast to every other
19 Section 7 case of which I am aware in which an
20 injunction or divestiture has been ordered.
21 The shareholder was either in the same or an
22 adjacent relevant market to that of the issuer and/or
23 sought to control the issuer. The legal basis of
24 common ownership liability on the parameters that I
25 have noted is not obvious.

1 In addition, the shareholdings of common
2 owners involve no scrambling of eggs. If the common
3 owner participates in unlawful collusion with its
4 issuers, a share divestiture order along with other
5 obvious remedies could easily be implemented.
6 Limitations on common ownership would distort
7 experienced investment judgment. Proper
8 diversification may not be achievable only across
9 sectors. Investors would be trying to select only
10 winners in each sector. Let the professionals decide
11 if proper investment requires diversification within a
12 single sector.
13 I close with another observation of Judge
14 Easterbrook, and I trust is costly. We already have
15 effective antitrust laws that protect markets from
16 anticompetitive behavior. No new law or guideline
17 limiting investment discretion is necessary and it
18 would impose distortions that almost certainly would
19 harm far more consumers than it would help.
20 MR. RUBINFELD: Thanks, Bill. I'm at a bit
21 of a loss because I'm imagining the additional panel
22 membership of Frank Easterbrook, my friend, sitting
23 here. It's a looming presence, but I will get past
24 that and say that we have a little time for some
25 questions from the audience.

1 And the first question that was posed, which
2 I’d like anyone to comment on, we'll go down the row,
3 but if you have something that would be useful. And
4 the question was we haven't talked at all about hedge
5 funds or private equity funds. How should we think
6 about how either of those entities -- types of
7 entities enter into our analysis of common ownership?
8 Scott.
9 MR. HEMPHILL: I’m not going to insist on
10 going first on that one if --
11 MR. RUBINFELD: Anyone else? We'll just
12 play it by ear. Anyone want to respond to that
13 question?
14 MS. MORTON: I mean, they seem a bit more
15 like the traditional partial ownership rather than
16 something that -- the relatively novel common
17 ownership I think that we're more focused on.
18 MR. RUBINFELD: Anyone else still?
19 MR. ADKINSON: I guess if I extend the
20 question to consider whether they might be investing
21 only in one other competitor in the industry, and how
22 they might offset some of the --
23 MS. MORTON: Oh, I think they don't. I
24 think -- don't we know that? That it’s the strategy
25 in Silicon Valley to invest in competitors and to --

1 well, I won't say -- I don't really have a lot of data
2 on this, but I think this is a common thing.
3 MR. PATEL: I think this does raise the
4 point that was mentioned earlier, though. If we were
5 going to take seriously the competitive dynamic that
6 common owners are owning horizontal competitors and
7 that is the driver of this, we need to buy into the
8 whole theory, and the whole theory acknowledges that
9 that large investor's hedge funds, index funds have
10 ownership interest across, up and down in
11 complementarities and in substitute markets as well.
12 If we buy -- if we are basing our policy prescriptions
13 on horizontal ownership, we need to take into
14 consideration all ownership of those common owners.
15 MR. HEMPHILL: To the extent that the
16 question is about their strategy as a noncommon owner
17 rather than strategy as a common owner, you know, this
18 would be a special case of part of what I was trying
19 to get across that there's circumstances in which you
20 would expect a firm that's invested -- you know, an
21 investor that has stakes in just one firm in an
22 industry to be pushing back on whatever strategy is
23 being cooked. I don't accept the idea that it is
24 always the case that, you know, this rising tide will
25 lift all boats, right?

1 The strategy -- there is a set of
2 strategies. In fact, it's the set of strategies
3 that's being tested by the MHHI literature that's
4 premised on there being a disagreement, a conflict,
5 between the common owners and the noncommon owners.
6 And, so, to the extent you think that that's a
7 plausible strategy, then you would expect firms that
8 are invested in just one to be pushing back on that.
9 MR. ELHAUGE: So I would say sometimes the
10 hedge funds are horizontal shareholders, but sometimes
11 they're not. But the big issue when they're not is
12 can they get the support of the other shareholders to
13 the extent they are horizontal shareholders. And just
14 empirically, there's research indicating that
15 increased index fund ownership is associated with a
16 statistically significant decline in hedge fund
17 activism.
18 So that might suggest that hedge fund
19 activism often is unable to succeed or
20 disproportionately unable to succeed in cases where
21 they're facing horizontal shareholders, and that would
22 be consistent with their more procompetitive efforts
23 to try to increase individual firm competition be more
24 likely to be thwarted because they can't get the votes
25 to win in the control contest.

1 MR. RUBINFELD: Okay, thank you all.
2 Another question that was posed by the audiences
3 covers something we've kind of taken for granted.
4 We've avoided talking about board membership because a
5 number of the analyses we've been talking about looked
6 to possible competitive harms that occur without any
7 board membership. But let's consider for the moment a
8 company like Berkshire Hathaway that might decide when
9 it takes a significant position in an industry to
10 expect to have board membership.
11 And my question is -- or the question from
12 the audience is how would that board membership
13 necessarily affect or not affect the kinds of issues
14 we're talking about when, for example, Berkshire
15 typically is not -- may or may not be active as a
16 board member. What can we say, if anything, about how
17 board membership might add to or subtract to --
18 subtract from the theories we've been talking about?
19 Anyone?
20 MR. ELHAUGE: Well, it's going to be a
21 pretty powerful direct mechanism, I guess, if you have
22 a board representative, right? You don't even have to
23 have an indirect communication.
24 MR. RUBINFELD: Well, board membership,
25 first of all, Berkshire Hathaway maybe not being an

1 example. Board membership may -- it may still involve
2 someone, typically minority ownership, the minority
3 owner may or may not have much impact on the outcome.
4 MR. ROONEY: Well, we can't forget the
5 presence of Section 8, so that there would be board
6 membership on only one issuer or not on the competing
7 issuer.
8 MR. HEMPHILL: I think there's -- I mean, I
9 don't know if this is part of what's contemplated by
10 the question or not. I think the threat of board
11 membership, right, I own a bunch of shares, and so
12 maybe I could, you know, cause a board member to
13 change or threaten to add somebody, subtract somebody
14 from the board, you know, that's a strategy that would
15 play out, if at all, over a medium to long term. It
16 would take a while to make that happen.
17 And, so, you'd want to, I think, consider
18 how effective that is, given how long it would take,
19 and also given what we know is a certain amount of
20 churn in putting index funds to the side in the
21 ownership, the different, you know, names held by
22 active funds, whether they hold onto to them for long
23 enough on average to actually render that threat
24 credible and actuated, I think, is not obvious.
25 MR. RUBINFELD: Thanks. So another question

1 from the audience question puts -- Bill, you’re off
2 the hook on this one, but it puts the academics here
3 on the spot, which is have any of the academics on the
4 panel interviewed corporate CEOs or I think other top
5 corporate executives and actually asked them how, if
6 at all, they take common ownership into account in
7 terms of their pricing decisions and other strategic
8 decisions. So you're all on the spot, academics. Who
9 have you been speaking to and what have you asked
10 them?
11 MS. MORTON: I have not interviewed a panel
12 of CEOs. That's pretty hard to do.
13 MR. RUBINFELD: You mean your name is not on
14 their list, Fiona, okay.
15 Anyone else?
16 MR. PATEL: No, likewise. I haven't either.
17 One wonders the accuracy of that exercise, but I have
18 not interviewed them.
19 MR. RUBINFELD: Well, I think Menesh's point
20 is that we usually like to get a substantial sample
21 size, and that would be pretty difficult.
22 I have interviewed quite a few CEOs, but I
23 have not broached this question, but I’m the neutral
24 observer anyway.
25 Scott, have you?

1 MR. HEMPHILL: I'm not for this -- in this
2 context. I mean, I think absent a CID, I’m not sure
3 that a negative answer -- I’m sorry, absent compulsory
4 process, I’m not sure that a negative answer would be
5 probative. I mean, I guess, maybe one side to test,
6 if they said, yep, I’ve been waiting for you to stop
7 by, I’ve been wanting to unburden myself.
8 MR. RUBINFELD: And I think it's true
9 actually that academics, most of us, at least on the
10 economics end, often try to draw inferences from
11 decisions people make, not from what they tell us
12 they’re thinking.
13 So with that in mind, I think we have enough
14 time to just go around the panel and give everyone a
15 chance to make any final comments they want before we
16 close this session. And I'm going to, following on
17 the last session, I'm going to try to reverse the
18 order here if it's okay.
19 So, Bill, we'll give you the first shot. Do
20 you have anything else you’d like to add to the
21 discussion.
22 MR. ROONEY: Just my thanks for being on the
23 panel first of all and being able to interact with
24 folks who spent so much time on this issue and
25 published so deeply and broadly and impressively. And

1 I think that in a sense I'm bringing or I'm offering a
2 perspective that is not fully engaging with the
3 economics of the theory, and I just was trying and I'm
4 trying to couch the dynamic debate that's happening,
5 from an economic and theoretical and econometric
6 standpoint in a legal context, and how that would
7 transfer in a careful examination of whether the
8 common owner really would -- has a serious plausible
9 risk of Section 7 liability within the parameters
10 we're talking about today.
11 MS. MORTON: I'd like to bring us back to
12 what Martin said about the fundamental tradeoff here
13 being between diversification and competition. And
14 there is no escaping that tradeoff. And to encourage
15 the FTC to be an agency for all citizens.
16 It's just remarkable how few citizens own
17 any stocks. It's really the bottom two-thirds of the
18 income distribution doesn't own stocks in America, and
19 many, many stocks are held by the top 1 percent who
20 are getting diversification from private equity,
21 foreign stocks, real estate, and lots of things
22 besides the fourth airline.
23 So who is it who's getting diversification
24 that's meaningful from the fourth airline? Well, it's
25 people like me, actually. I have enough money to be

1 saving, and I don't have enough money to have any
2 private equity, so I’m in a mutual fund, index fund.
3 But there just aren't that many of us.
4 And when you think about the tradeoff I get
5 from the fourth airline, diversification versus how
6 much I'm paying in higher prices, that's the thing
7 that we need to work out through further research and
8 so on, how big is that difference. But then we also
9 have to remember that only 20 percent of the
10 population cares about that tradeoff, that the other
11 81 -- 80 percent of them don't care at all about
12 diversification, and the top 1 percent probably
13 doesn't care very much either.
14 So the distributional consequences of this
15 debate are really substantial.
16 MR. ELHAUGE: So a few points, one just
17 picking up on the question about do managers say that
18 this is what we're doing, our pricing based upon
19 horizontal shareholding. I want to emphasize, I don't
20 think anything in the theory depends upon managerial
21 consciousness. Take the executive compensation, it
22 could just be that they naturally follow their
23 compensation incentives and thus compete less. For
24 voting, it could just be that shareholders vote for
25 the sort of managers who are less competitive. And it

1 could simply be the absence of shareholder pressure to
2 compete. So nothing depends upon managerial
3 consciousness of this.
4 Second, on MHHI levels, there's a lot of
5 critiques of them, but I want to emphasize that it's
6 not like the anticompetitive effects are being assumed
7 from the MHHI measure. It's a hypothesis that's being
8 tested. Now, I think it could be tweaked. And for
9 that matter, HHI isn't that terribly accurate either.
10 You need to tweak it for, you know, case-specific
11 facts. I myself have a paper proposing one possible
12 tweak to the MHHI measure, something different in the
13 differentiated market. I think we could take into
14 account perhaps better the different percentage fees
15 that different funds have or the different flow
16 incentives that they have.
17 But it seems pretty clear from empirical
18 evidence that just assuming there's no aggregated
19 voting and there's no effect at all is wrong because
20 if you ignore that aggregation, then you don't find
21 anything statistically significant because you're
22 using a measure that's not related to anything,
23 whereas the measure is validated by the fact that it
24 does statistically relate with high level confidence
25 to prices.

1 And, lastly, I want to emphasize something
2 that Fiona mentioned, which is there's a tradeoff, I
3 think, here between what we’re going to do in merger
4 analysis, what we’re going to do in horizontal
5 shareholding analysis. If we're going to allow
6 horizontal shareholding, we are, it seems to me, going
7 to have to lower the concentration levels we allow in
8 mergers, and that does mean that we’d be prohibiting
9 more mergers that would otherwise be more efficient.
10 It seems quite likely to be better off
11 allowing efficient, relatively concentrated markets
12 and giving up on some of this horizontal shareholding
13 than having unfettered horizontal shareholding but
14 having deconcentrated markets that are less efficient.
15 MR. RUBINFELD: Thank you.
16 Menesh.
17 MR. PATEL: Thank you. Yeah, the FTC is to
18 be applauded for holding not just this hearing but
19 this whole slate of hearings. It really demonstrates
20 the vitality and robustness of our antitrust laws.
21 I'll close where I started, and that is that
22 this is a new issue with many complexities. However,
23 there are large aspects of it that relate to the
24 issues that we, as antitrust scholars, practitioners,
25 and regulators, have thought about for a very long

1 time. And those existing tools, when applied to this
2 new manifestation of potentially anticompetitive
3 behavior, can result in policy prescriptions that are
4 consonant with antitrust, as it has been for the past
5 decades.
6 MR. RUBINFELD: Scott.
7 MR. HEMPHILL: I guess the governing thought
8 is that we ought to be splitters rather than lumpers.
9 I mean that in two senses. First, I think we should
10 really be working hard to nail down what we think is
11 happening in each situation, to work out what we think
12 the mechanism is at work in different empirical
13 studies.
14 For example, take the two pharmaceutical
15 studies that Einer mentioned. You know, one of them
16 roughly is about common ownership increasing -- I
17 mentioned pharma competition because I think I've had
18 conversations individually in other contexts with
19 everybody else on this panel on this set of subjects.
20 One is about common ownership potentially increasing
21 the prevalence or likelihood of reverse payment
22 settlements. That's a strategy that's presumably to
23 the benefit of both the brand and the generic that's
24 in the nature of reverse payment settlements. That
25 might be an example of the rising tide lifting, in

1 that case, both boats.
2 The other is about common ownership just
3 making the generic less likely to enter vigorously.
4 It just sort of discourages the generic from entering.
5 If I’ve correctly characterized the study, that would
6 be an example of the brand benefitting but the generic
7 losing out, right? That's perfectly possible as an
8 implication of common ownership, but it's not one that
9 both of the firms are going to equally like, and it's
10 not one that the noncommon owners of each are going to
11 equally like, right?
12 If you're a hedge fund invested in the
13 generic, you're likely to resist the common owner
14 telling the generic that it needs to take one for the
15 team -- to take one for the common owner’s team. So
16 that’s one kind of splitting.
17 The second kind of splitting is simply to
18 come back to where I started, that the analysis of
19 common owners needs to really take account of these, I
20 think, systemic important differences in the incentive
21 and ability to pursue anticompetitive strategies. And
22 I think there's a big difference between a Berkshire
23 Hathaway in this respect and a BlackRock or a
24 Fidelity.
25 MR. RUBINFELD: Thanks, Scott.

1 I want to thank everyone on the panel for
2 their help in the minute and their comments, but I did
3 want to make one final comment myself. When I teach
4 my antitrust students about both law and economics,
5 one of the things I tell my students is that there's
6 about a ten-year lag between the kind of deep research
7 that goes into thinking about the issues we're talking
8 about.
9 Academics go back and forth. We debate, we
10 push, we shove, we kick, whatever. And eventually, at
11 least in many cases, some clear conclusions are
12 reached, or we hope they are, and policy follows. So
13 I think there's roughly a 10, sometimes 15-year lag
14 between the analysis that the academics are doing and
15 some of the important court decisions that follow.
16 Why do I say this? Because we're really --
17 even though it's true that Dan and Steve and others
18 have done work in partial equity ownership issues for
19 a long time, the work that Martin and his colleagues
20 have done has moved us into a new area, and it's been
21 very recent. We're talking about the last couple
22 years that really focused work has gone on in this
23 area.
24 My hope will be that we'll continue the work
25 on this area and think about it deeply and be careful

1 about the policy conclusions we draw until we have
2 some really certain -- at least reasonably certain
3 results about where this is taking us.
4 So on that thought, I want to thank everyone
5 on the panel for an excellent discussion. Thank you
6 all very much.
7 (Applause.)
8 MR. ADKINSON: I would like to thank the
9 panel as well and mention we're going to have a 15-
10 minute break and then our final panel on econometrics,
11 so please come back sharp in 15 minutes.
12 (Recess.)
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1 **ECONOMETRIC EVIDENCE OF COMPETITIVE HARM**
2 **FROM COMMON OWNERSHIP**
3 MR. WILSON: Good afternoon, everyone. My
4 name is Nathan Wilson. I'm an antitrust economist at
5 the FTC. Today, I'm going to be moderating the last
6 but certainly, I think, not the least panel of the
7 day, focusing on the Econometric Evidence of
8 Competitive Harm from Common Ownership.
9 Thus far today, we have heard various
10 speakers provide important background details, as well
11 as discuss the core theoretical elements of common
12 ownership. Now, we're going to turn our attention to
13 discussing the efforts that have gone into testing
14 whether or not those theories seem to match what
15 appears to be happening in the real world.
16 We are fortunate to have a panel composed of
17 authors that have contributed to this subject from its
18 very infancy. Now, two of our panelists should be
19 familiar faces, having provided framing remarks
20 earlier this afternoon. They are Dan O'Brien, now of
21 Compass Lexecon, and Martin Schmalz of the University
22 of Michigan's Ross School of Business.
23 Joining Dan and Martin are Serafin Grundl,
24 who is a Senior Economist in the Financial Structure
25 Section of the Federal Reserve Board. His research

1 focuses on industrial organization, and his policy
2 work is concerned with antitrust issues in the
3 financial sector.
4 Next to him is Christopher Conlon, Assistant
5 Professor of Economics at the New York University
6 Stern School of Business. His recent studies have
7 looked at interactions between taxes, regulations, and
8 competition among practitioners -- among firms, excuse
9 me. Separately, he has also developed a number of
10 tools for antitrust practitioners.
11 Our fifth and final new panelist is Nancy
12 Rose, Department Head and Charles P. Kindleberger
13 Professor of Applied Economics in the MIT Economics
14 Department. She has served as Deputy Assistant
15 Attorney General for Economic Analysis in the
16 Antitrust Division of the DOJ from 2014 to 2016, and
17 was the Director of the National Bureau of Economic
18 Research Program in Industrial Organization from 1991
19 through 2014.
20 Our panel will begin, as previous ones have,
21 with individual presentations. After these initial
22 remarks, there will be a moderated discussion, but
23 time will be reserved at the end for questions from
24 the audience, either from those here at NYU or
25 potentially from those watching remotely. Please note

1 that FTC staff will be circulating throughout the
2 panel with comment cards if you have a question you
3 would like me to ask.
4 Now, without further ado, I would like to
5 turn the floor over to Serafin.
6 MR. GRUNDL: Thanks, Nathan. So I would
7 like to thank the FTC and NYU for inviting me to this
8 panel and for hosting it. And like so many others
9 before me, I have to start with a disclaimer, and that
10 is that I'll only present my own views, maybe the
11 views of my coauthor Jake Gramlich, but not the views
12 of the Fed Board or any of its staff.
13 And in my remarks, I will focus on
14 methodological issues. I will not comment on
15 potentially conflicting findings or conflicting
16 conclusions, you know, when different people look at
17 the same findings. And I hope to give a little bit of
18 an introduction and hopefully it kind of sets up the
19 rest of the panel.
20 So my copanelists and I, we have, I think
21 broadly speaking, used and advocated for three
22 different methodological approaches. Martin and José
23 Azar in their seminal studies have used an approach
24 where they relate MHHI, which is a concentration
25 measure that takes common ownership into account, to

1 price levels. And the idea is that without common
2 ownership, MHHI collapses to the HHI, so the gap
3 between the MHHI and the HHI is a measure of how much
4 common ownership affects concentration, and if that’s
5 related to prices, maybe there’s an impact of common
6 ownership on prices.
7 The second approach, which is, you know,
8 dear to the hearts of IO economists, is a structural
9 approach. So I’m also an IO economist, so I also like
10 that one, and Dan and Chris have papers advocating for
11 that one, so it’s similar to the kind of exercise we
12 do when we do a merger simulation, so we specify the
13 complete structural model of the industry, enhanced
14 for the fact that we also allow for the effects of
15 common ownership.
16 And I will be talking mostly about a third
17 approach that Jake Gramlich and I have used that I
18 call testing comparative statics, and I will talk
19 about what I perceive to be the strength and
20 weaknesses of this approach, especially compared to
21 the structural approach.
22 So what's our question? We have two
23 competing theories. The incumbent theory is -- Theory
24 1 is each firm maximizes its own profits, common
25 ownership or not. That’s what we usually assume. And

1 the challenger theory is Theory 2, which is that each
2 firm maximizes a weighted average of its own profits
3 but also of the profit of its commonly held rivals,
4 and it assigns these weights -- WIJ -- to the profits
5 of these rivals.
6 And we want to develop an econometric test
7 that distinguishes Theories 1 and 2, so we need to
8 find some testable predictions to do that. So that's
9 kind of a straightforward exercise in a sense because
10 obviously Theory 1 predicts that changing the profit
11 weights has no effect on anything that are part of the
12 theory. And Theory 2 predicts that changing the
13 profit weights changes everything, okay, every outcome
14 of this particular action between firms -- prices,
15 quantities, profits, whatever you can think of,
16 exit/entry decisions, investment, advertising,
17 everything should be affected by changes in these
18 profit weights.
19 Now, the way I've explained it is slightly
20 simplifying because you can't really base a test yet
21 on this. Ideally, what you want to have is a monotone
22 comparative statics result so you want to have a
23 prediction of the theory that changing the profit
24 weights changes one of the outcomes in a monotone way,
25 and then you can design a test distinguishing Theories

1 1 and 2.
2 And the last ingredient we need is we need
3 obviously variation in the profit weights, and this is
4 generated by changes in ownership, combined with
5 theory that tells us how does ownership translate into
6 these weights, for example, the one that Dan helped to
7 create.
8 Now, what are the strengths and weaknesses
9 of such an approach? So I think one of the important
10 strengths is that relatively weak restrictions are
11 sufficient to obtain monotone comparative static
12 results. So under -- just placing some restriction on
13 the competition between firms, we get predictions, for
14 example, that if Firm I starts to care more about the
15 profits of Firm J, it will respond by competing less
16 aggressively, increase its price, and decrease its
17 quantity.
18 In particular, we do not have to impose
19 conditions that are sufficient for identification. We
20 only have to impose conditions that are sufficient to
21 generate testable predictions.
22 The second point that I've listed here is
23 kind of a special case of the first point. We do not
24 even have to specify a full model. So we do, for
25 example, not have to specify a demand system. We will

1 just have to make high-level assumptions, such as
2 firms are competing in the sense that their goods are
3 substitutes.
4 And then a practical advantage of this
5 approach is it's relatively easy to implement. By
6 that, I mean it's easy compared to, say, estimating a
7 structural model, there's no numerical optimization or
8 things of that kind. And if someone, say the FTC,
9 wanted to do a study where we look at many industries
10 and collect outcome variables for many industries and
11 ownership structures, then you could do this in a
12 fairly straightforward manner.
13 Now, there are also downsides of this
14 approach. And one that Dan has pointed out in his
15 work, which is that it's not so easy to do the way I
16 just described it in practice. What you would like to
17 do is you would like to estimate how your outcome
18 variables at a price depends on the complete set of
19 these profit weights in a flexible way.
20 And because there are so many profit
21 weights, you cannot actually do that, so you will have
22 to define certain functions that you hope summarize
23 the effects of the different profit weights. So you
24 may want to control for how much does each of I's
25 competitors care about the profits of Firm I, but in

1 practice, you can only control for how much do they
2 care about the profits of Firm I on average, and you
3 hope that this is good enough.
4 And the second downside is kind of the flip
5 side of the advantage that I mentioned earlier, which
6 is that we only test the direction of the effect. So
7 we impose fairly weak restrictions, those that give us
8 directional predictions of the theory, but not more
9 than that. And if you have a complete structural
10 model, you will, in effect, get predictions also about
11 the size of the effect.
12 So, for example, the structural model will
13 tell you if you get your demand system right and you
14 get the parameter estimates right, how close
15 substitutes are, you know, the products of Firm I and
16 J, and that will have implications for if Firm I cares
17 more about the profits of Firm J, will it respond a
18 lot or will it respond a little. And Firm I and J
19 don't really compete because their products are not
20 close substitutes, maybe Firm I will not respond much.
21 And this kind of more specific prediction is something
22 that you get out of a structural model but not of our
23 approach.
24 And I'll leave it at that. I'm curious to
25 hear what my copanelists have to say.

1 MR. WILSON: Thanks a lot, Serafin.
2 Now turning it over to Dan for the next
3 remarks.
4 MR. O'BRIEN: Great, thank you. Earlier, I
5 talked about the theory that grounds the empirical
6 studies on common ownership, and now I want to turn to
7 the empirical evidence. And in my discussion of
8 theory earlier, I raised two issues that I will assume
9 away for the purpose of discussing the empirical
10 evidence. First, I assume that even though
11 institutional investors purchase shares across a broad
12 set of industries, I'm going to assume that it's
13 reasonable to focus on one industry such as airlines,
14 banking, breakfast cereals, or whatever.
15 Second, I'm going to pretend that it's
16 reasonable to assume that the objective of individual
17 investors is to maximize the value of their retailer
18 investors' shareholdings in the industry under
19 analysis. So those were Warning Signs two and three
20 in my previous presentation, and I'm going to
21 basically assume those away. By making these
22 assumptions, I don't mean to suggest that they're good
23 ones but making them facilitates a coherent discussion
24 of other critical empirical issues that arise in
25 assessing common ownership.

1 So let me start with the empirical question.
2 The heart of the question is whether common ownership
3 causes firms to behave less competitively by raising
4 price, reducing output, cutting capacity, investment,
5 or what have you. The way this happens in theory is
6 that firms' managers take into account the effects of
7 their decisions on the profits of rivals and thus pull
8 their competitive punches.
9 The accounting for rivals' profits that
10 managers do is captured in what I call common
11 ownership incentive terms, and these reflect a
12 fraction of each rival's profit that a manager
13 accounts for in making strategic decisions for the
14 firm. So in a five-firm market, for example, each
15 firm faces four rivals, and there would be 20 common
16 ownership incentive terms -- five times four. These
17 terms are accounting for the profits of each rival,
18 and each firm does that. So there are 20 common
19 ownership incentive terms which Serafin alluded to a
20 moment ago, which makes certain empirical analysis
21 difficult.
22 Let me pause and observe that the common
23 ownership incentive terms that I'm talking about, and
24 these are discussed in the paper that I've written
25 with some colleagues. The terms subsume the financial

1 interests and control weights of all of the owners
2 that are part of the theory. Okay, that’s measuring
3 the -- estimating the common ownership incentive terms
4 amounts to measuring the impact of the control
5 weights, which as I mentioned earlier are critical,
6 that reflect the control or influence exerted by the
7 owners.
8 Okay, so if it seems like we're a little bit
9 deep into the weeds here, let me say that this is
10 actually on purpose because there's quite a desperate
11 need for a view from the weeds that I think this issue
12 is now getting, which is good. Like all rigorous
13 science, it makes sense to express the problem in a
14 way that's as simple as it is but not simpler.
15 And I want to commend Serafin for going back
16 to what we learned in IO 30 years ago about how to do
17 empirics, which is do comparative statics, which is
18 basically writing down a theory, seeing how things
19 change when other things change, and seeing whether or
20 not that holds true in the data.
21 Okay, so let's move out of the weeds just a
22 bit and talk about how we measure these critical
23 common ownership terms. There's basically two
24 approaches. One approach is called the reduced form
25 approach, to simplify. And that’s to estimate a

1 relationship between price and some measure of common
2 ownership, which should be the common ownership
3 incentive terms in some way since those are what
4 matters.
5 This is the approach that we see in the
6 empirical research, the airline paper and the banking
7 paper which got this whole thing started. And a
8 difficulty with this approach is that theory tells us
9 that prices depend on the full panoply of common
10 ownership incentive terms. The interaction of these
11 terms with each other, and the interaction between
12 these terms and cost and demand factors, this makes it
13 impractical to estimate a true reduced form because
14 there are just too many variables. The airline and
15 the banking papers address this problem by using an
16 index to summarize common ownership, and that was the
17 MHHI that we've been talking about. But this creates
18 problems that I'll discuss in a moment.
19 The other empirical approach is to build an
20 oligopoly model and measure the common ownership
21 incentive terms as they appear in that model. The
22 advantage of this approach is that it's possible to
23 capture the full panoply of interactions in a rigorous
24 way. And this is the approach that I've pursued in my
25 own study of the effects of common ownership in the

1 airline industry.
2 The comparative statics approach that
3 Serafin talked about I would classify as a variation
4 on the reduced form approach because you don't specify
5 the full structural model but you come up with
6 relationships that you should see in the data if
7 there's any competitive effects going on, and so I
8 think I would put that in there, but maybe there's a
9 nuanced difference as well.
10 So let's talk about the empirical approach
11 in the airline and the banking papers that found that
12 common ownership raises price. The airline paper uses
13 two approaches -- a price regression that relates
14 airfares to route-specific MHHI and quasi difference-
15 in-differences analysis that exploits the
16 BlackRock/Barclays merger to try to see whether or not
17 the impact that that had on common ownership affects
18 price.
19 The diff-in-diff analysis is really a
20 variant of the reduced form approach that I mentioned,
21 and both approaches are pursued in the banking and the
22 airline papers have some shortcomings that make me
23 quite skeptical. The problem with the price MHHI
24 regression is that the MHHI is a measure of
25 concentration, not a measure of common ownership.

1 So there are two issues here. One is that
2 common ownership has multiple dimensions, all those
3 common ownership terms I mentioned, okay? And the
4 MHHI has only a single dimension. So it's generally
5 not possible to capture the impact of common ownership
6 that way.
7 The second problem is the MHHI depends on
8 market shares, and market shares move up and down for
9 a lot of reasons that have nothing to do with common
10 ownership. So I’ll reserve -- I want to give you one
11 example, and then I'll preserve the rest of my remarks
12 for the Q&A, but it's not possible to determine the
13 effects of common ownership by looking at the
14 correlation between price and the MHHI. Okay, it's
15 not possible.
16 So let me give you an example. It just
17 snowed in Tahoe, it’s ski season, and the demand for
18 air travel to Tahoe has risen. Okay, airfares rise,
19 and an airline with very flexible capacity takes
20 advantage and sees its share rise relative to less
21 flexible airlines. So if the flexible airline is a
22 big guy, price and the MHHI both rise. The reason is
23 that an increase in the big guy's share increases the
24 MHHI. If the flexible guy is a little guy, price goes
25 up but the MHHI goes down, okay? The reason is that

1 an increase in the little guy's share reduces the
2 MHHI.
3 So this illustrates that price and the MHHI
4 can move in the same direction or in opposite
5 directions for reasons that have nothing to do with
6 common ownership. Thanks.
7 MR. WILSON: Many thanks, Dan.
8 And now we’re on to Martin.
9 MR. SCHMALZ: So thanks very much. Once
10 more, I unfortunately have to not speak about
11 particular empirical approaches or papers but about an
12 entire literature. And, so, let me start with the
13 baseline again. The baseline is that we have decades
14 of evidence of institutional ownership effects,
15 capital expenditures, payouts, merchant activity, and
16 so forth. More recently, we have evidence that common
17 ownership measure in various ways affects corporate
18 financial choices. That’s not surprising given that
19 the big institutional investors directly express views
20 on the level of payouts and CapEx firms should take.
21 Now, how's that related to competition?
22 Well, every dollar that’s paid out in the form of
23 payouts can’t be spent again on capital expenditures
24 in the same firm. So reduced capital expenditures
25 means lower capacity; lower capacity means lower

1 output, and there's a competitive effect, okay? So if
2 there is an effect of common ownership on capital
3 expenditures and payouts, how could there not be an
4 effect on product markets?
5 Now, most of the studies, indeed, have been
6 more recent, but let me give you an entire overview.
7 First come studies that documented an economy-wide
8 increase in common ownership, and that's been going on
9 a long time, including in VCSS, a view hypothesized
10 earlier. Let me just point out, one paper published
11 in the JFE that concludes that by 2005 already most
12 institutional investors in S&P 500 firms do not want
13 corporate managers to narrowly maximize the value of
14 their own firm, instead, investors would see their
15 portfolio values maximized if managers internalized a
16 large percentage of any externalities imposed on other
17 firms. Okay, so this is just mainstream finance, and
18 since then, this has been continued. We'll hear from
19 Chris later on.
20 Now, when does the literature on empirical
21 evidence on anticompetitive effect start? So José, my
22 coauthor and classmate, in his dissertation shows that
23 a measure of common ownership density predicts
24 industry margins. Okay, then come two authors here
25 from NYU who showed ownership of firms by quasi-

1 indexers is causally related to an increased level of
2 buybacks and reduced investment, which is precisely
3 the mechanism proposed earlier relative to margins.
4 Now, the only reason apparently our study
5 with José and Isabel made such a buzz is because we
6 were the first to study market-level effects,
7 indicating that common ownership is variable and is
8 causally related in a reduced form way to higher
9 prices, as well as reduced output. And that has been
10 independently replicated, but the data and code is
11 available on the JF website after they replicated
12 this, so everybody can see how robust these findings
13 are or not.
14 Now, a bit of detail on this. These results
15 have been shown to only apply in particular markets,
16 for example, only markets with relatively high levels
17 of concentration to start with, substantially above
18 2,500 points. The second is that it's, of course, not
19 just based on correlations as Dan just illustrated
20 with this Lake Tahoe example. And, of course, it is
21 true that MHHIs depend on market shares.
22 That’s why many of the tests are just
23 literally fixed or even set to one over the number of
24 players counterfactually, so we know that this is not
25 what drives the results. Okay, that does not exempt

1 the study from any of the other criticisms, but they
2 have to be a little more complicated than what is
3 being levied here, okay?
4 So it hasn’t been mentioned so far today,
5 but in the discussion, there has been a paper claiming
6 that our results were driven by weighting the
7 regressions by the number of passengers in a route,
8 which you want to do because you're interested in the
9 average effect on a ticket price and not on, like, a
10 route as an outcome variable, as well as by the
11 largest 5 percent of markets. Now, these claims are
12 just factually incorrect, and again you can see this
13 on our websites. There are links to the paper that do
14 that.
15 What I'm showing here is the regression of
16 price on MHHI deltas that are not weighted by the
17 number of passengers and you see that in the first
18 column that the effect is there in a full sample in
19 the largest 5 percent of markets and the lowest 95
20 percent of markets, so the results are just not driven
21 by weighting regression.
22 So how is it that these authors come to the
23 conclusion that in so many markets they're not there?
24 Well, it appears that they made a data error. They
25 failed to aggregate 13(f) holdings, which is where we

1 get most of the ownership information from, to the
2 level of the institution that actually votes them.
3 When we do the same mistake, simply commented out of
4 our code, we also find that the effects appear to be
5 driven only by the largest 5 percent of markets and
6 are not present in the full sample or the bottom 95
7 percent but it's just a data error. Okay, so that
8 turned out to be a nonissue.
9 Now, let me jump over this a little bit.
10 There is a thing called the structure conduct
11 performance critique, and I don't think I have time to
12 cover both -- all of it, other than saying that, you
13 know, when you talk to an IO economist, you sometimes
14 come away with the impression that there's only a
15 single way to conduct credible empirical analysis, but
16 some of the biggest minds in this field concluded that
17 this seems a very narrow and dogmatic approach to
18 empirical work, and credible analysis comes in many
19 guises and so forth.
20 So, you know, there's a difference between
21 identifying causal effects of one variable on the
22 other and the structural analysis. Now, that said,
23 there have been economic structural studies of common
24 ownership as early as the late '90s. One of the
25 studies of common ownership of telecom licenses finds

1 that it explains higher prices. Now, that's between
2 two firms, okay, so this is just two firms, each
3 owning 50 percent. And they looked at the commonly
4 owned that explains price 5 percent higher than a
5 common ownership. Lundin looks at Swedish nuclear
6 power plants and finds that if they're commonly owned,
7 that explains that prices are 5 percent higher than
8 they would be without common ownership.
9 And on the best work by far, most careful in
10 this literature, we'll hear about by Chris, and they
11 find -- they don't estimate effects on prices of
12 common ownership. They rank models by whether a
13 common ownership model performs better than a Bertrand
14 model, and the answer is clearly no. So there's one
15 market, one particular industry, rather, that where
16 that model is outranked, okay?
17 Now, obviously, that doesn't reject that
18 there are positive effects of common ownership in any
19 other market, so I don't think we should use that as
20 an argument that the literature needs to stop.
21 Rather, this can be applied in many, many other
22 industries and people should, of course, do that.
23 Now, in his paper that Dan referred to, we
24 wrote a reply to that as well a long time ago, more
25 than a year ago, I believe. The paper finds no

1 positive effects, but it also doesn't reject positive
2 effects because the standard errors are so large as we
3 understand. Also, it finds a negative effect of the
4 length of a route on the cost of flying route. Now,
5 that seems counterintuitive to -- you know, based on
6 any economic logic, and all the estimates are based on
7 10 percent subsample of the data, and there's no
8 justification we could make out for that.
9 We tried to replicate that with the full
10 sample and do not manage to replicate a nonpositive
11 effect, but to be honest, the incentives to an
12 academic of replicating industry studies are pretty
13 low. And, so, that's one of the reasons why I
14 encourage regulators to take a look at that. That's
15 their natural role of the competition authority.
16 But my broader comment is that the singular
17 focus on MHHI really misses the forest for the trees.
18 There are many, many papers in this literature -- at
19 this point roughly two dozen -- that estimate effects
20 on firm behavior and market structure, innovation,
21 entry, as we said, using alternative measures of
22 common ownership as well.
23 So, again, my point here is not we found,
24 like, the crystal ball and everybody should use this
25 particular measure, but the insistence that no matter

1 the level of common ownership, we shall just assume
2 that there are no effects. That has been clearly
3 rejected by the literature.
4 So one is an effect in venture capital
5 showing that common ownership fosters alliances among
6 the VC-backed firms, and there's a banking paper which
7 is subject to similar criticisms as the airline paper,
8 but one reason I want to mention it is because they
9 always split out -- we recently have split out the
10 passive investors -- the so-called passive investors
11 and the active investors and the effects seem to be
12 almost exclusively driven by the quasi-indexers, so
13 that goes to Scott Hemphill's request to start looking
14 at different types of owners.
15 There are other papers that show that the
16 reduced competition from market share seems to be
17 effectuated via reduced advertisement expenses, many
18 other things. The two pharma studies came up.
19 Gerakos and Xie show that common ownership predicts
20 the probability of a settlement that includes pay-for-
21 delay where the brand keeps a generic drug out of the
22 market and independently that's reduced, and the entry
23 result has been replicated by other authors with
24 slightly different methods.
25 There is a bunch of other studies I don't

1 have time to talk about. And there are more than a
2 handful of studies of the effect of common ownership
3 on corporate innovation. Again, He and Huang, for
4 example, has published in the *Journal of Financial*
5 *Economics*, so those are top journals. The gist of it
6 is that depending on if the common ownership is within
7 industry or across industry and if it’s long-term
8 owners and short-term owners and so forth, there can
9 be a positive or a negative effect on corporate
10 innovation.
11 But even if the effect was unambiguously
12 positive, the welfare effects, of course, aren’t
13 clear, right? So we know that the innovation effects
14 would have to overpower any anticompetitive effects,
15 and that only happens on the very restrictive
16 conditions and theory. And we have no empirical
17 evidence of welfare-enhancing effects.
18 There are also effects of vertical common
19 ownership links. Ojeda is a Berkeley Ph.D. student,
20 shows that if there's common ownership between a bank
21 and a firm, that firm tends to get lower -- so loans
22 with lower interest rates, and riskier loans whereas
23 as the noncommonly owned ones pay higher interest
24 rates. And there's a bunch more in the literature as
25 well.

1 So the takeaway from that is, of course, it
2 doesn't mean that horizontal effects exist or sign the
3 net effect, so the argument that if we just had one
4 giant index fund that owns all firms, all productive
5 capital in the economy, there would be no problem, and
6 it appears wrong to me because an index fund would not
7 own the economy; it would own the productive capital.
8 And maximizing social welfare is a different thing
9 from maximizing producer rents.
10 Okay, now, I just ran over a list of 23, 24
11 papers in 12 minutes or so, that gives 30 seconds per
12 paper. I'm afraid I could not do justice to the
13 evidence in that amount of time, but I just want to
14 encourage the FTC to hear some of these other 40
15 authors of the other papers as well if they want to
16 get a reflective view on the state of the empirical
17 literature. And to be clear, this is not meant as a
18 criticism. This is meant just as a statement that
19 this panel here does not reflect the state of the
20 empirical literature.
21 Okay, so, to conclude, I've said before that
22 I think the quality of this debate would benefit from
23 better data access to researchers and independent
24 analysis of product markets. Data access, we're being
25 scolded here about using ownership data that's

1 incomplete or voting data that is uninformative.
2 Well, it’s very simple, then we should have better
3 disclosure of data to the regulators.
4 So it's not okay if the industry at the same
5 time scolds the academics for using faulty data and
6 lobbies the regulator at the same time for disclosing
7 this. That doesn’t make much sense. To the
8 regulator, I think it’s important to do studies
9 themselves for multiple reasons. One I mentioned
10 before. Why can’t we ask the academics to first
11 produce the results based on data that we cannot
12 possibly produce. That leads to a catch-22.
13 The second, with all due respect I have for
14 the substance of Dan’s work, I’m worried that if we
15 base this discussion on sponsored research we get
16 coverage similar to what the economists had last week
17 or last month, which I think can be damaging to the
18 agencies. And it doesn’t mean that I endorse the
19 coverage; it means that I take that seriously, and I
20 think we should avoid that. I think today’s hearings
21 are great for a step in that direction of doing work
22 themselves and getting informed. So thanks again for
23 holding it.
24 Third, I mentioned that academics in some
25 cases may have reduced incentives of running, say, the

1 work that Matt and Chris and others are doing on,
2 like, 50 more industries. We don’t get published in a
3 top journal for that. So that is another natural
4 role, even if we had the work for the competition
5 authorities to do.
6 Lastly, it seems that the industry is not
7 interested in the Commission to focus its resources on
8 this topic. And I think it’s worth thinking about why
9 that could possibly be so. I would have expected that
10 if transparency is in the interest of us all that then
11 we should want the FTC to study this topic in all
12 imaginable detail.
13 So, again, there are many open questions.
14 We’ll hear about some of them. Dan raised a few
15 others as well, which we can better answer with better
16 data access. Serafin’s paper alludes to that as well.
17 I don’t think focusing our attention on other topics
18 is going to answer these open questions. So given the
19 state of the literature, given the basic theory that
20 we have, given the enormous levels of common ownership
21 that have been documented for decades, and given the
22 abundance of mechanisms, I don’t think it's reasonable
23 to just assume there's no effect and continue with
24 business as usual. But, instead, I think the
25 competition authorities should study this topic.

1 Thank you.
2 MR. WILSON: Thanks, Martin.
3 And now Chris.
4 MR. CONLON: All right, thanks. I'm going
5 to go fast here because people covered a lot of this
6 stuff. So I'm going to mostly focus on sort of facts
7 and what I'm going to call sort of positive results,
8 and I'm going to leave my sort of opinions to the
9 panel discussion at the end, with one caveat that I'll
10 show you in a second.
11 So, yeah, as Martin sort of alluded to, the
12 data on ownership are sort of unusually bad. We spent
13 about a year going through and scraping all the SEC
14 filings for the SEC database post 2000. We've gone
15 through all the 13(f)s in the Thomson Reuters
16 database, for all the firms in the S&P 500. You might
17 wonder, like, why does Thomson Reuters only find that
18 there's 400 or 450 firms in the S&P 500 in certain
19 quarters. That's sort of a level of how bad the data
20 can actually be, but we've cleaned this up as best we
21 can, and we're going to try to make it available to
22 other researchers, assuming that Thomson Reuters
23 doesn't sue us.
24 Okay, so, yeah, so there's been some debate
25 about what is the object of interest. The thing that

1 I’m going to call kappa here on the right is the thing
2 that Serafin and Dan referred to as the profit weight.
3 And what it is is it's just a measure that says how
4 much -- how many shares do you earn in a particular
5 firm as an investor and then how much does that firm
6 actually pay attention to you as a particular
7 investor.
8 And I think, kind of, there's a lot of
9 debate, and I think there’s a little bit of a false
10 choice here in that there’s this, like, well, we
11 should either focus on profit weights or this MHHI
12 delta and that these are like two very distinct, very
13 different measures. And what I want to just tell you
14 is that the profit -- the MHHI delta literally is that
15 profit weight, but it's that profit weight multiplied
16 by the market shares of the two firms and then summed
17 up for all the firms in the market.
18 And what happens is we throw away kind of a
19 lot of variation that we might have. We often see
20 these asymmetries in these profit weights, where I
21 might want to care a lot about your profits as a firm,
22 and you might not want to care very much at all about
23 my profits. And when we sort of summed it up into a
24 market-level measure, we kind of lose a lot of the
25 interesting variation, right? There's other issues

1 that people have referred to that this -- you know, if
2 I'm going regress a price on something that looks like
3 the quantity, you can say that it's a demand curve; I
4 can tell you it's a supply curve; and we can sort of
5 agree to disagree. And that's, I think, kind of where
6 some of the disagreement is.
7 So I'm going to show you sort of large
8 aggregates for what happens with these profit weights
9 for the whole economy, and these are results I think
10 people haven't seen before. So imagine everybody is
11 indexed, everybody buys the market portfolio and you
12 either buy X percent of Firm 1 or Y percent of Firm 2.
13 It might very well be that you put a weight of more
14 than one on another firm's profits. In fact, you
15 know, if everybody does that, the best predictor of
16 what the profit weights are going to be, at least in a
17 cross-section, is the institutional share or one minus
18 the retail share, right, and I'll show you that,
19 right?
20 So, yeah, the other thing that I should
21 point out is that the thing that doesn't seem to
22 matter much is investor concentration. What matters
23 is how relatively concentrated investors are, that is,
24 are your investors more concentrated than mine. So
25 here is sort of -- here's sort of the long-run trend.

1 So we do this for all the firms in the S&P, every pair
2 of the 500 firms. We plot this from 1980 to the
3 present, we'd find that a firm might put a weight of
4 .2 on another firm's profits. It could be in a
5 completely different industry, and by today, that
6 weight is closer to .7, so it's really changed a lot
7 over time.
8 Do the control assumptions matter if I put
9 more weight on the largest investors or more equal
10 weight on investors? Those are what all the different
11 colored lines are, and basically, towards the end of
12 the sample, they all pretty much converge. Right, so,
13 the answer is control should matter and in practice it
14 mattered a lot less than we thought it was going to.
15 What actually drives these profit weights?
16 So one of the best predictors in the cross-section,
17 not looking across time, is just retail share. So the
18 firms that seem to really like their competitors are
19 companies like Apple and Pepsi and these big behemoths
20 with lots of retail investors, right?
21 What's driving the long-run trend? It seems
22 to not so much be that investors are getting larger
23 but all the investors are buying the index. Right,
24 it's that more and more investors are holding
25 portfolios that look like the market portfolio. And

1 that seems to be what's driving these long-run
2 results.
3 Right, so now let me get to sort of the
4 micro data. So this is where we looked at the market
5 for cereal. Right, and we sort of -- we took sort of
6 every approach we could. So we started with -- we
7 started with sort of Martin's approach, and we
8 regressed prices on the HHIs and MHHI deltas. And we
9 found that HHIs increased prices but that the MHHI
10 delta for a thousand-point increase in the MHHI delta,
11 prices went down between 8 and 12 percent in a way
12 that was statistically significant and robust to every
13 specification we could throw at it.
14 Now, we don't think increasing common
15 ownership is going to actually reduce prices for
16 cereal. Right? We then took the approach that
17 Serafin and Dan recommended. Suppose -- now I only
18 have 16 profit weights because there's four firms that
19 really matter in cereal. If I run the regression of
20 prices on those things, what did we find? Well, we
21 found that about three of them were positive and
22 significant, about three or four of them were negative
23 and significant, and that the rest were zero. And,
24 so, we didn't know what to make of that, right?
25 And, so, then what we did is we said, well,

1 look, how would the FTC approach this as if it were a
2 merger case. So we could estimate a model of demand,
3 just like we would conduct a merger simulation. We
4 could back out marginal costs from estimates of
5 demand, assuming that either firms were playing the
6 Bertrand game, like we usually do, or assuming that
7 firms were following these common ownership weights,
8 and we could recover estimates of marginal cost. Then
9 we could take everything we think that should shift
10 that marginal cost and we could project our estimates
11 of marginal cost on that stuff, right?
12 And what I've plotted here is fake, but what
13 I've plotted is sort of those marginal costs -- those
14 recovered, leftover bits of marginal cost over time,
15 right, and what we could do with those recovered bits
16 of marginal cost over time is we can see if they
17 respond to other things that marginal costs absolutely
18 shouldn't respond to.
19 And what are those things? Those are things
20 that move markups around, right? So one thing might
21 be to look at events in the financial space, right, to
22 look at things like the BlackRock or Barclays merger.
23 But another thing might be to look at things that
24 don't shift my marginal costs but do shift the
25 marginal costs for other products.

1 So for cereal, this was actually quite easy.
2 So we have cornflakes. Cornflakes should respond to
3 the price of corn. The cost for cornflakes should
4 respond to the price of corn, but they absolutely
5 should not respond to the price of rice. Now, the
6 markup on cornflakes might respond to the price of
7 rice, but the idea is we've subtracted off already the
8 right markup. So if we have the right model of
9 competition, we have the right markup. And, so, that
10 shouldn't be in what remains in marginal cost. And,
11 so, that's the basis of our test, right?
12 And, so, the idea is I've drawn sort of two
13 squiggly lines here, and so if I have the right model,
14 my marginal cost should look pretty flat. And if I
15 have the wrong model, then around these events I
16 should see big spikes in my marginal cost, right? And
17 we use that and we use multiple events in both
18 directions. We use multiple events in both directions
19 that both led to increases or decreases, and we found
20 that they don't line up so well for common ownership.
21 In fact, for ready-to-eat cereal, we found
22 that actually Bertrand fit the data pretty well. And
23 in some sense, this was a bit surprising, you know,
24 because this wasn't like we chose this as a case where
25 we knew ex ante, you know, cereal was going to behave

1 this way. Why? Because the ready-to-eat cereal
2 industry has been, you know, accused of being in price
3 wars and in price-fixing cartels and in various
4 conspiracies going back to the '70s, and about once a
5 decade, they get involved in something like this. So
6 this is an industry where we could have found
7 something and we didn't. All right, so that’s where
8 I'm going to leave it for now.
9 MR. WILSON: Thanks very much, Chris.
10 And our last speaker will be Nancy Rose.
11 MS. ROSE: Thanks. So I wanted to thank the
12 FTC for inviting me to participate and particularly to
13 correct a misimpression, which is I'm not one of the
14 authors. I’ll say a little bit more in a minute about
15 that, although this is a topic that I have followed
16 with a lot of interest and quite closely since
17 Martin's presentation of his airline paper to the
18 Department of Justice Economic Analysis Group Seminar
19 Series in the fall of 2014, shortly after I arrived
20 there. So I haven't been at it as long as Martin has,
21 but I’ve been following this with intense interest.
22 And I just also wanted to echo the important
23 debt that I think we owe to Martin and to José Azar
24 and to their various collaborators for conducting the
25 seminal empirical work on this issue, which has

1 sparked the debate on which today's entire set of
2 hearings has been founded. And as an academic and as
3 a former antitrust enforcer, I think flagging these
4 issues, getting people excited about them, getting
5 people interested in them, and trying to learn the
6 truth is really important.
7 That said, I find myself as one of 23
8 speakers in the category that Martin labeled as no own
9 empirics, factually incorrect, industry-affiliated, or
10 sponsored, and that Fiona, after deducting herself and
11 Einer from that, seemed to suggest the rest were
12 seemingly superfluous, if not -- did not belong in the
13 debate. And I'm hoping that that won't be your
14 conclusion.
15 While I haven't written on this topic, one
16 of the things that I teach my students in the MIT
17 Department of Economics is that one can and should
18 read and critically analyze papers, even if you
19 haven't done your own empirical original research on
20 that topic, and I'd like to share with you some of the
21 thoughts that have emerged from my analysis of this
22 literature.
23 To give the top-line conclusion for reasons
24 that I'll explain, I don't think that one can conclude
25 that case for anticompetitive effects of common

1 ownership has been proven at this point, and I want to
2 say that the reason someone who is as passionate about
3 invigorating antitrust enforcement as I am is putting
4 that view out there because I think it's important for
5 us to base policy discussions in particular on bedrock
6 and not on shifting sand, both so that we get to the
7 right place and so that if we do need to undertake
8 either changes in the way we're approaching antitrust
9 enforcement or in legislation around these issues,
10 that those policies are not derailed by somebody
11 proving that the empirical paper you're using to
12 support your analysis is noncredible.
13 And that's why I think I'm very encouraged.
14 I think there are many more economists that are
15 engaging empirically with this question, particularly
16 people coming out from the industrial organization
17 tradition, which I think has a lot to contribute to
18 it. And for those of you who haven't read Chris' and
19 Matt’s and Mike Sinkinson's work in this space --
20 they've now got three papers, which I think are all
21 terrific, terrifically interesting, and I’d pair them
22 up with Scott Hemphill's as sort of your foundational
23 knowledge in this.
24 Okay, so what are the two main points I want
25 you to come across with? To some extent, most of them

1 have been said before, but I think they're worth
2 emphasizing. The first is that the way we're
3 empirically implementing common ownership measures I
4 think does not reflect really anyone's incentives
5 accurately. So most empirical papers look like
6 something on -- I guess it's your right -- where
7 you've got one guy who owns all four airlines and is
8 thinking about how to maximize the value of his
9 extremely large portfolio. But, in fact, the common
10 ownership ecosystem is much more complicated. We've
11 got lots of people -- retail investors, some pension
12 funds, some union funds and so forth -- that might be
13 contracting with a fund or investment vehicle that's
14 managed by what I'll call big asset management.
15 But big asset management is not a monolith
16 either. Big asset management is composed of Bob's
17 Value Fund, which in this example holds American
18 Airlines, Hyatt, Dollar Tree, lots of other stuff;
19 Betsy's Growth Fund, which might hold United Airlines,
20 Marriott, and lots of other things; and an S&P index
21 fund, which maybe is managed by a computer algorithm
22 which holds, you know, everything in the S&P.
23 And, now, if we ask sort of what are the
24 incentives that are driving this, so first note, even
25 for the guy on your right, Ron, yeah, if all he owns

1 is airlines, we’ve estimated the right -- we're
2 looking in the right space, but if he also owns
3 hotels, he's not maximizing the value of his portfolio
4 by maximizing the value of his airline holdings.
5 And while Dan said he's going to make that
6 simplification to be able to make some progress in
7 empirical work, I don't think we can learn about this
8 theory if we’re saying, well, we think these guys
9 maximized the total value of their portfolio but only
10 silo by silo, right? I just think that’s a really --
11 it’s a good place to start, it's a good place to get
12 us engaged with the problem, but it's certainly not a
13 place to finish.
14 So if we look on the right and we ask what's
15 going on there, now let's think about Bob and Betsy's
16 incentives. So big asset management owns both
17 American and United, but people are investing in Bob's
18 fund, an actively managed fund, because they expect
19 him to beat the benchmark, and people are investing in
20 Betsy’s fund, an actively managed fund, because
21 they’re expecting her to beat the benchmark. Neither
22 of them have an incentive to sacrifice the
23 profitability or the value of the airline that they
24 own so that the other airlines can make money.
25 And I think that's what's been lost in a lot

1 of the discussion and a lot of the literature is that
2 it's not particularly interesting, I think, to tell us
3 that the big four airlines, particularly as we get
4 past the financial crisis and the merger wave, also
5 seem to be pretty cozy with one another. And in
6 contrast, if you're in a market where it's got one or
7 two of the big airlines but you've also got Spirit and
8 Allegiant, I think if I asked most of you to say, here
9 are two airline markets; HHI is 5,000; two firms,
10 equal shares; one is American United, the other is
11 American Spirit, which market has the lowest price, I
12 think almost none of you would say I can't answer that
13 question until you tell me what the ownership
14 structure looks like among these institutional asset
15 managers.
16 So I would urge us to sort of recognize that
17 and to key very tightly on Scott's, I think, very
18 careful thinking about what these tests can tell us,
19 and I think common ownership tests are going to tell
20 us most about that theory when we can observe firms'
21 declining profitable deviations from collusion,
22 sacrificing their own profits from rivals' profits.
23 And, yet, what I've heard throughout the day are
24 comments like, but, of course, everybody is happier if
25 profits go up.

1 I will leave you with the thought, happy to
2 talk about it during the discussion, that we have two
3 airline data points that suggest to us that that
4 theory of, of course, everybody's happier with higher
5 prices, they'll all go along, is first not a test of
6 common ownership but maybe also not a good
7 characteristic of that particular market. Let me stop
8 there.
9 MR. WILSON: Thanks very much, Nancy.
10 At this point, I want to loop back to some
11 of the issues that came up in various folks' initial
12 presentations and kind of drill down a little bit
13 more, perhaps identifying areas of disagreement and
14 potentially leading to tests that may resolve some of
15 that disagreement in the future.
16 And the first issue I wanted to kind of
17 touch on was the issue of measurement. In particular,
18 people have talked about the various ways of
19 addressing common ownership in different forms of
20 empirical analysis, and some have preferred one versus
21 another. And I guess I'm particularly interested in
22 hearing about how alternatives to the ones you may
23 have employed or preferred could be driving in one way
24 or another the results of papers that you have
25 questions about.

1 And I'm certainly also interested in
2 anyone's thinking about kind of concrete ways of
3 measurement kind of unrelated to my primary question.
4 Perhaps Dan would like to take first crack at this.
5 MR. O'BRIEN: Sure, Nate. So measurement --
6 so we're trying to measure common ownership and we
7 want to know whether or not changes in common
8 ownership cause anticompetitive effects. So my first
9 observation, and I made this clear in my remarks, I
10 think, is that the MHHI is not a great measure of
11 common ownership, at least in a price regression,
12 because it can move in directions that reflect
13 increases or decreases in common ownership because
14 it's complex, it's multidimensional, it just doesn't
15 move in directions when common ownership changes that
16 tell us common ownership has gone up, and then how
17 those movements relate to price changes also doesn't
18 tell us whether or not common ownership is affecting
19 price because they can move in the same direction or
20 opposite directions. So I don't think that's a great
21 way to measure things.
22 But it's a conundrum for reduced form
23 empirical work because if you buy into the theory, and
24 perhaps we need a new theory about how to think about
25 this that's simpler. If you buy into the theory, you

1 have all of these common ownership incentive terms,
2 these weights that Chris talked about. And they all
3 matter, and in an oligopoly model, they interact in
4 complex ways with everything, and you can't run a
5 simple reduced form price regression that captures all
6 of that.
7 And to give -- to throw some credit to
8 Martin, he was faced with this problem, and he chose
9 to use the MHHI, which is an index that relates in
10 some way to common ownership, and so it's probably not
11 a bad first choice in thinking about how to summarize
12 this.
13 So I think a better way to go is a
14 structural model that tries to model how the oligopoly
15 works, effectively estimates different control
16 scenarios to see which one is most consistent with the
17 data, and that's the approach that we adopted in the
18 structural analysis of the airline market that we did.
19 And we found that, in fact, we couldn't reject that
20 common ownership has no effect on price -- well, we
21 couldn't reject that common owners had no control. We
22 could reject that common owners had proportional
23 control.
24 As Martin said, there are positive levels of
25 common ownership that we couldn't reject if your

1 hypothesis was that those would hold. I think that’s
2 a better approach, but there needs to be, you know,
3 more thought about how best to estimate this, and this
4 is -- Serafin talked about some things and Chris is
5 talking about some things. So that's my observation.
6 MR. WILSON: Thanks, Dan.
7 Chris, would you like to add anything to
8 that?
9 MR. CONLON: Yeah, I guess the one thing I
10 would add on top of that, yeah, I’m clearly, I think,
11 in the camp that I’m not -- I think we've learned as
12 much as we're going to learn from MHHI. I think it
13 was -- it's useful in the same way that HHI is useful
14 as sort of an initial screen to sort of, you know,
15 describe markets, but, you know, in terms of, like, is
16 it -- do I believe we can get a causal link between
17 overlapping ownership and prices by regressing things
18 on HHI or MHHI, if only we had the right instrument?
19 I'm a little bit skeptical, I think for the same
20 reason that the IO literature, you know, 30 years ago
21 sort of stopped running these price concentration
22 regressions.
23 I will say, actually, in the appendix of one
24 of Dan's papers is another measure that actually
25 bothers me a little bit less, and that’s his sort of

1 like delta-PPI measure. And that looks a lot like
2 what the agencies also do in sort of screening mergers
3 again in sort of a differentiated product world, which
4 says if I knew the profit weight and I knew the
5 diversion, the ratio at which people switch to the
6 competing good, well, then, that should give a model
7 of how much common ownership could increase my
8 effective costs, right? And you can think about what
9 is common ownership doing. It's raising the
10 opportunity cost of selling my product because now
11 when I raise my price, well, some people are going to
12 switch to your product, and will I care at least 30
13 percent about them or 40 percent about them?
14 And I think there might be some ability to
15 sort of push in that direction so that we can bring in
16 things like differentiated products, because I think
17 we know most of the markets we care about today
18 actually have differentiation, which I think was maybe
19 not true 50 years ago when we were making bars of
20 steel and pulling coal out of the ground and things
21 like that.
22 MR. WILSON: Thank you.
23 Anyone else? Martin.
24 MR. SCHMALZ: People might want to look at
25 the CRCO terms that are in the airlines papers which I

1 applied similar to what Chris just mentioned, so it's
2 not just based on MHHIs.
3 If I may, I'll also just clarify once more,
4 my point was not that there's no role of other people
5 on the panel other than those that have done empirical
6 research. All I said is that today's panels and this
7 panel is not reflective of the empirical literature
8 that has been done today. So I'm sorry you feel this
9 way, but this was not the intended criticism.
10 MR. WILSON: Thanks.
11 So before we leave the issue of measuring
12 common ownership, I want to kind of keep us focused a
13 little bit, particularly given that I've received a
14 question that seems related, about dealing with the
15 endogeneity of ownership itself. Is there some way
16 that we can be concretely confident that we are
17 accurately accounting for the selection into owning
18 different stocks and the validity with which different
19 papers may have addressed that question?
20 MS. ROSE: Could I kick that off, because I
21 don't have a particular empirical ax in this, but my
22 suspicion is, and this is based a little bit on
23 looking at some of the profit weights or common
24 ownership rates and some of the just broad literature
25 on pairwise common ownership measures, say of

1 companies, is that to some extent, what we're learning
2 with common ownership is almost an indicator that says
3 these are both big, national or global companies,
4 right?
5 It's not purely that, but to some extent,
6 what it's picking up is, for instance, a lot is
7 driven, say, by S&P index funds, right? So if you're
8 in the S&P 500, your degree of common ownership is
9 very high. If you're way far out of the S&P 500, then
10 your degree of common ownership with another firm is
11 likely to be quite low.
12 And, so, one of the things that I think --
13 it’s not an endogeneity in the way we usually think
14 about it. It’s more an omitted variable or a
15 heterogeneity. But that goes back to my airline
16 example, it was chosen for that particular point,
17 which is, you know, Delta, American, United, Southwest
18 are all the big guys and we might think have more
19 common interests in softening competition among them,
20 maybe common business strategies, much less so with
21 the smaller guys. And I think what we need to
22 struggle with is how can we find variation in common
23 ownership that isn't driven by that.
24 It's one of the things I like in the cereal
25 application because Chris has found with his

1 coauthors, have found a setting where you’ve got some
2 variation in common ownership not being driven by kind
3 of firm size.
4 MR. WILSON: Sure.
5 MR. SCHMALZ: So to speak from a finance
6 researcher perspective, basically all equilibrium
7 models in finance we have just say all shareholders
8 should be perfectly diversified. The only reason why
9 you wouldn't do that is in order to have an increased
10 influence on your portfolio firms. And there are some
11 literature on -- in the VC space that deals with this
12 that you might want to reduce the breadth of your
13 portfolio to have a greater impact on your firms. But
14 other than that, we don't have much at all.
15 For sure, we don’t have a well-accepted
16 model that spells out the endogeneity of ownership,
17 product prices, asset prices, voting behavior, and I
18 don’t know what. You know, all the others that have
19 been mentioned today is open issues. Yes, they are
20 open issues. But if you wait until that model has
21 been written, that could be 250 years or so then. So
22 that’s a sure -- you know, and then just estimate that
23 model in a beautiful IO way. So that's just not going
24 to happen.
25 So if one wants to make any progress on this

1 issue, we have to accept some limitations of the
2 models that they make and so the endogeneity of
3 ownership is certainly one where we don't have much
4 theoretical guidance at all.
5 MR. WILSON: Okay, thanks.
6 Dan?
7 MR. O'BRIEN: Yeah, I mean, I was just going
8 to -- you know, we had to tackle that a little bit in
9 our structural model as well, and, I mean, ideally,
10 you know, a big model would have a structural model of
11 the airline industry or whatever industry you're
12 studying and also, you know, you would model the
13 investment process itself. Nobody's developed that
14 model at the level of being able to empirically test,
15 so -- but you can think about instrumental variables,
16 right, that capture, you know, the extent of ownership
17 in a -- in a company. And so -- that capture the
18 extent of common ownership.
19 So that's what we tried to do using the
20 BlackRock/Barclays merger as Martin did and also the
21 Russell stock indices as instruments.
22 MR. CONLON: Yeah, so, in the cereal
23 industry, I think what was nice about our set -- the
24 reason we chose it was that Kelloggs is dominated by a
25 large family foundation, so they're the largest

1 shareholder. And, so, you can basically see they
2 don’t care so much about the profits of other players.
3 Post, the fourth largest -- third or fourth
4 largest firm, starts out as part of Philip Morris,
5 gets spun off by Philip Morris, sort of goes and gets
6 IPO'd, and so it's bouncing in and out of various
7 indices. And, so, you see huge spikes, both up and
8 down, in sort of the weight that they put on the other
9 firms in the market.
10 The other firm that's sort of interesting is
11 that Quaker Oats is a division of Pepsi, and Pepsi has
12 this massive retail share. It’s like what retail
13 investors invest in, they invest in stuff like Pepsi.
14 And, so, they often put a weight of more
15 than 100 percent on sort of their -- what should be
16 their competitors’ profits. And I think that’s in
17 part what led us to choose this, was that we got a lot
18 of variation in common ownership because when we
19 looked at sort of the macro evidence, those plots I
20 showed before, what we kind of showed was, like, these
21 profit weights were going up over time and they were
22 kind of just going up, up, up, and it seemed to mostly
23 be driven by indexing.
24 We might worry that indexing isn't, you
25 know, endogenous in the sense that people aren't

1 buying -- you know, investing in Fidelity and
2 BlackRock because, you know, these firms are colluding
3 in the product market. But I think our fear was that
4 we didn't want to just pick up a positive increasing
5 trend, and so we wanted stuff that was sort of moving
6 both up and down over time. And so that's why we
7 chose cereal in the first place.
8 MR. GRUNDL: So kind of to emphasize this
9 point, I think it's useful, though, with industries
10 where some of the firms are not actually listed on the
11 stock market. So, for example, in banks there are
12 about 5,000 banks in this country not publicly traded
13 that did not experience an increase in common
14 ownership over the last, you know, 20 or 30 years.
15 Their traded competitors did.
16 Theory predicts that these traded
17 competitors, they pulled their competitive punches,
18 and the privately owned banks, they should benefit
19 from that. So that's a prediction of the theory that
20 can be tested at this kind of broad level if you have
21 competitors that are not on the stock market.
22 MR. WILSON: Thank you.
23 Martin.
24 MR. SCHMALZ: So just to continue this
25 conversation, I'm skeptical. So it's nice to have

1 this variation. It’s nice to have the variation from
2 private actors, but, then again, we have no idea what
3 the objectives are. So a private firm shareholder
4 might maximize all kinds of things, including the
5 private benefits of running a firm or being able to
6 expense stuff on his business account.
7 So it's nice to have that variation, but it
8 raises new issues at the same time. My favorite
9 example of that is always I think there's some
10 anecdotal evidence that large shareholders, other than
11 Richard Branson, also tend to stand for competitive
12 strategies. So when I think of a very competitive,
13 say, car company, I think of Tesla, and Elon Musk
14 holds a huge stake in it, and then people tell me, oh,
15 yeah, but that’s because he's crazy. So maybe the
16 same reason he holds this large stake is the reason
17 for the competitive strategy and it has nothing to do
18 with competitive incentives.
19 So all that is just to illustrate,
20 beautiful, here we have lots of variation, but it
21 doesn't really solve the question of answering the
22 question of what the endogeneity is at cost variation
23 in the first place. So that brings me just back to
24 the point that we don't have good models of that, and
25 that’s why, for the moment, finding shocks that are

1 plausible -- plausibly exogenous to the product market
2 is the best thing we can do.
3 MR. WILSON: Okay. Keeping the focus on
4 kind of heterogeneity and diversity, I want to kind of
5 turn to an issue that has come up I think already
6 today a bit, which is that some owners are different
7 than others and the potential implications that may
8 have for appropriate empirical framing.
9 And, Serafin, do you want to start us off on
10 that?
11 MR. GRUNDL: Yes. I think this is a really
12 important issue, and that's probably why it came up so
13 often. So for the most part, we treat, you know, Jeff
14 Bezos and Vanguard and Berkshire Hathaway and the
15 Swiss Central Bank and maybe the Norwegian Sovereign
16 Wealth Fund, you know, all the same way in these
17 common ownership studies. Martin just mentioned that
18 they started to work on this a little bit. We, in our
19 latest paper, try also to differentiate between
20 different kinds of shareholders and have good reasons
21 to believe that different kinds of shareholders have
22 both different incentives and different means by which
23 they can affect firm management.
24 So, for example, the distinction between
25 asset managers and investors who invest their own

1 money could be important, could not, but it's an
2 empirical question. The distinction between actively
3 managed or asset managers that mostly have funds that
4 actively -- you know, are actively managed as opposed
5 to asset managers of most VF funds that are passively
6 managed could be irrelevant.
7 And perhaps one, you know, thing that I
8 would like to stress in this context is that this
9 matters no matter what your preferred candidate
10 mechanism is. So if you think that your candidate
11 mechanism involves the common owners to influence the
12 managements of the firms that they commonly own, then
13 does heterogeneity among shareholders matter?
14 But if you kind of, you know, flip the
15 burden of proof, as I think Martin wants to do and
16 say, well, the default state of the world is that
17 managers, you know, they don't want to compete and
18 someone has to push them or incentivize them to
19 compete, then it also matters if these shareholders
20 are different, then it matters in their role as, you
21 know, large undiversified shareholders that could
22 potentially push for more competition.
23 So either way, I think shareholder
24 heterogeneity is important and at least in principle
25 it can be investigated empirically.

1 MR. WILSON: Thanks.
2 Martin, do you want to pick up from there?
3 MR. SCHMALZ: Nope.
4 MR. WILSON: That’s totally fair.
5 Chris?
6 MR. CONLON: Sure. So I’ll say we actually
7 tried to do this. We tried to get data on who was
8 active and who was passive. It's very hard. You
9 know, even like for a large firm, like Fidelity, like
10 is Fidelity -- do they have some actively managed
11 funds, they have some, you know, clearly just low-cost
12 index funds, and so there is some within the finance
13 literature, there is some kind of agreement, I think
14 that Brian Bushee put together on sort of who's active
15 and who's passive.
16 You know, the list looks okay, but it
17 wouldn't look super convincing, at least not the parts
18 that we were able to match up. So, yeah, I think -- I
19 mean, I think, like, as long as you don’t put -- I
20 think what we found, like, it was pretty robust to --
21 at least in aggregate, it was pretty robust to how
22 much weight we put on different people. And, so, the
23 massive driver in aggregate seems to be the move
24 towards indexing. And, so, unless you put, like, all
25 your weight on these really concentrated active folks,

1 I think you're going to find at least in the long run
2 that these weights have been going up.
3 Now, whether or not these weights are
4 translating to anything in the product market I'm not
5 willing to say, but, yeah, that's about what we found.
6 MR. SCHMALZ: So I didn't say this because
7 it's obvious in the literature but not -- perhaps not
8 in all literatures. This active/passive distinction
9 is difficult also because you have fund families that
10 host both active and passive funds. So Fidelity, one
11 example; BlackRock another. Vanguard is probably the
12 most passive one of them all. But the empirical fact
13 seems to be that in most cases, all of the funds get
14 voted together and that the engagement and stewardship
15 happens.
16 I see the people who have actually studied
17 voting nodding here. So there are exceptions from
18 that rule, and it seems to be that the predominantly
19 passive asset managers tend to be those that tend to
20 vote all the shares together more so than others, but,
21 you know, to which extent -- where we're going to draw
22 the line between calling that an actively managed one
23 and not.
24 Another one is like a crook of the finance
25 literature. How many indexes do we have now? The

1 answer is 3.7 million, okay? So we have 3.7 million
2 indexes, and anything that tracks an index is
3 considered a passive fund, like the ETF nowadays are
4 out there is, like, on South American timber or
5 whatever, or the Jets ETF. Now, that has very little
6 to do with diversified investment as, you know, we
7 talked about democratizing investment for the American
8 consumer. But it counts as a passive fund, but it's
9 ridiculous because literally the 70th percentile of
10 indexes is used by only one fund. In other words,
11 that's as active as it ever gets. So these statistics
12 are which fraction of an asset manager are actively
13 managed versus passive. You have to take them with
14 lots of grains of salt, and this classification is,
15 therefore, very difficult and perhaps also just not
16 even useful, given that voting happens in a
17 centralized way.
18 MR. WILSON: Thanks. One quick followup on
19 that from me, which is that it seems like there is
20 wide agreement that there is diversity here. The
21 extent to which that diversity may or may not manifest
22 itself in different behavior in terms of common
23 ownership is a bit in question. But is there any
24 sense in which we could -- we can sign or come up with
25 a reasonable theoretical hypothesis about the effect

1 that mismeasuring these things may have on the
2 estimated relationship between common ownership and
3 various product market outcomes?
4 MR. SCHMALZ: The obvious first answer is if
5 it's measurement -- pure measurement error, you get an
6 attenuation of the coefficients, so in order to get a
7 false positive coefficient, you have to cook up a
8 story of why there's an endogeneity here that goes
9 this way, and I'm not aware of one.
10 MR. CONLON: Do you want me to cook one up?
11 This is like -- I guess this is my specialty, I don't
12 know. No, I would say, like, I think the -- I mean, I
13 think there are cases where we see in the data where
14 when you look broadly, you see cases where the set of
15 investors really changes around certain events. And a
16 lot of -- there is some randomness about, like, we
17 only see these investor holdings once a quarter.
18 And, so, like, when are investor holdings
19 kind of the weirdest? They're the weirdest usually
20 around a big corporate event, so like takeovers and
21 bankruptcies and stuff like that where the set of --
22 you know, you see all of a sudden these large hedge
23 funds coming in, playing some merger arm strategy or
24 they're buying distressed firms or all of a sudden,
25 you know, on the reporting day it happens that all the

1 former debt holders are now the equity holders because
2 the previous equity holders got wiped out.
3 And, so, like, I don't know, when we looked
4 at all the data across all 500 firms in the S&P 500,
5 like almost every time we found something that looked
6 super weird, it was around one of these financial
7 events. So, you know, if something goes up -- if the
8 weight goes up to like 1,000, you know, or down to
9 zero, you know, that could be all the variation in
10 your data. And, so, these outliers, you know, screwed
11 stuff up for us when we looked with the broad index.
12 MR. WILSON: Thank you.
13 All right, moving on to another topic kind
14 of themed around a question received from the
15 audience. So there's, I think, pretty clear
16 disagreement on the panel about the relevant merits of
17 different approaches and certainly the lay of the
18 evidence on the ground. But if we set the past aside
19 and we look prospectively towards the future, are
20 there approaches that academics or policymakers or
21 anyone interested in this issue could adopt that would
22 be at least reasonably acceptable or be taken
23 seriously by all panelists?
24 Dan, do you want to start us off on the
25 research design?

1 MR. O'BRIEN: Okay. I think the three
2 warning signs that I put in my earlier talk play
3 into the research design question for trying to
4 answer the question about the effects of common
5 ownership by institutional investors, okay? And two
6 of the signs -- two of the warning signs are, you
7 know, institutional investors are investing, you know,
8 in a broad set of industries. And the existing
9 empirical work is not paying any attention to that as
10 far as I can tell, or not much.
11 Okay, so the industries involve -- so the
12 investments involve companies that are substitutes for
13 each other and compete and companies that are
14 vertically related, okay, and companies that are
15 independent and maybe they're related for other
16 reasons besides traditional complementarities or
17 substitutabilities. And if you're going to apply a
18 theoretical framework to motivate your empirical
19 analysis, you have to take that into account.
20 So this is not so much a research design
21 point as it is, you know, there's a real need if you
22 want to apply this to the institutional investor
23 problem, to write down the right objective where, you
24 know, you're modeling, you know, what's actually
25 motivating the investment.

1 And then the second point I would say, and
2 again, I hate to sound unrealistic, this is more a
3 call for research, it’s that, you know, what are
4 institutional investors really interested in in
5 exerting whatever influence they might exert over
6 managers of companies. You know, is it maximizing
7 shareholder value across one industry as assumed by
8 the theory -- as the theory's applied to the empirical
9 work that got us here, or is it, you know, something
10 else that involves competition with, you know, other
11 institutional investors and that whole competitive
12 process. What that means for ways in which influence
13 is exerted, I think that’s just kind of an open
14 question.
15 My opinion is that, you know, that model,
16 which has been used to motivate a key explanatory
17 variable, holding aside the issues with that
18 explanatory variable, doesn't really apply to the
19 institutional investing problem because of these big
20 problems of asset managers having incentives that I'm
21 not sure we understand and the fact that what I called
22 the relevant common ownership group should include all
23 interrelated entities and it should model -- okay, the
24 MHHI is the wrong index, is another way to put it if
25 you're not accounting for all the interrelationships.

1 MR. WILSON: Okay, thanks.
2 Chris.
3 MR. CONLON: Yeah, okay, I want to sort
4 of -- yeah, I’m going to propose two additional things
5 we could look for in the data to find evidence that I
6 don't think anybody has done yet. So one is, look, if
7 we're already sort of quasi-cooperating, that is, if
8 I'm already putting the weight of a half on your
9 profits, well, then, we should systematically
10 overpredict the price effects of mergers that we see,
11 right? Because once we merge, the most weight I’m
12 going to put on your profit is 100 percent.
13 So if I'm already putting 40, 50, 60 percent
14 weight on your profit, now, a merger is actually going
15 to raise prices by less than we would expect, right?
16 Now, that presents other issues for the FTC about how
17 they should, you know, think about mergers in this
18 world, but I'm not going get into that.
19 And I think the other sort of implication
20 from the theory, if you take the theory seriously, is
21 that there could be these wild asymmetries in the
22 weight that I put on your profit, versus the weight
23 that you put on my profit. And I think we should be
24 able to see -- we kind of miss those when we mush
25 everything together in this MHHI, but if we see those

1 in the data, you know, we should be able to go looking
2 for stuff that looks like that, where one firm is just
3 very generous to this other firm, while the other firm
4 just really doesn't care and is competing pretty hard.
5 MR. WILSON: Thanks.
6 MR. O'BRIEN: Can I add one thing?
7 MR. WILSON: Sure.
8 MR. O'BRIEN: Just one thing. So I talked
9 about the institutional investing context and trying
10 to do empirical work there. I think there are
11 examples, which I don't have at the front of my head,
12 but there are examples in antitrust where you have
13 large investors that are taking positions -- you know,
14 the Richard Bransons of the world, the
15 noninstitutional investors where you have large
16 investors taking positions in multiple companies where
17 the theoretical framework that people have in mind
18 actually applies quite well, and it would be very
19 useful to study the impact of transactions that
20 involve, you know, changes in common ownership that
21 comes through those large investors or a few large
22 investors as opposed to institutional investors that
23 are investing across entire industries.
24 MR. SCHMALZ: Where do you see Berkshire
25 Hathaway in that space?

1 MR. O'BRIEN: I'd have to study exactly what
2 Berkshire Hathaway's holdings are because it's pretty
3 broad. And so I'm -- across a lot of industries.
4 MR. SCHMALZ: It's pretty concentrated in
5 airlines and banks.
6 MR. O'BRIEN: Okay, so it might work is what
7 I would say. But, you know, if it's airlines and
8 banks, is it airline suppliers and airlines buyers and
9 is it bank suppliers and so on? I mean, you need the
10 right group to study this, right? Or is it primarily
11 focused on one industry? And if it's one industry,
12 then I think the framework applies quite well.
13 MR. SCHMALZ: So let me respond to that. Is
14 it fair to call you predominantly a theorist?
15 MR. O'BRIEN: I am predominantly a theorist,
16 yes.
17 MR. SCHMALZ: Okay. So here's the thing. I
18 sympathize with all that. The entire day we've heard
19 speculation, mainly theoretical considerations of all
20 the things that the existing models and measures don't
21 capture. The question is how far you want to drive
22 this. And if you want to wait until we have a theory
23 of partial vertical common ownership, we have the
24 world authority sitting in the audience, Yossi Spiegel
25 here, and who has tried for decades to try to do this,

1 right, and doesn't, you know, manage to resolve all
2 these issues we're bringing up here.
3 In addition, you want to know what precisely
4 guides a firm’s objective. Oliver Hart, a Nobel
5 Laureate, tried this for a few decades and hasn't come
6 up with anything better than saying it’s not going to
7 be maximizing own-firm profits and all on your own.
8 And, in fact, we have, you know, Arrow’s impossibility
9 theorems that tell us, you know, it's not so clear
10 that there even exists such a thing as a firm
11 objective. They want that, you want vertical -- a
12 vertical theory. In addition, you want to endogenize
13 the asset manager’s incentive problems, and this is
14 just a theory.
15 And next, how am I going to apply this
16 vertical theory to the actual data, right? So I would
17 need which fraction of the sales of, like, this bank
18 goes in terms of bank loans to an airline to figure
19 out if the Berkshire Hathaway common ownership in this
20 vertical relationship matters or not. Where am I
21 going to get this data from? It doesn't exist. I
22 don't think anybody collects this. So I think what we
23 have to be a little careful about in this debate is
24 also to only ask questions or put this as like
25 roadblocks in the way of the literature that can

1 actually be answered and that have not been proven to
2 be unanswerable, like literally in some cases for
3 decades, and just say, oh, but there's these
4 unresolved questions, and the number of sunshine hours
5 is not in the models either.
6 MR. O'BRIEN: A real quick response, Martin.
7 I'm not asking for a theory of everything; I'm asking
8 for an empirical methodology, you know, that's
9 defensible and robust and valid and has an
10 interpretation.
11 MR. SCHMALZ: Very good.
12 MR. O'BRIEN: Yeah.
13 MS. ROSE: And I would just echo that. I
14 think it's not fair to say -- you've got a theory that
15 says that these asset managers are performing very
16 complex analyses to decide what their portfolio
17 company should be doing to maximize the value of their
18 portfolios. And either -- or maybe even more heroic,
19 the portfolio companies are figuring out what the
20 various owners must be doing in terms of -- or want
21 them to do in terms of maximizing these complex
22 portfolios.
23 And I understand to say, well, that's really
24 hard. But then where do you draw the boundaries? And
25 you've drawn them, you know, siloed within an

1 industry, and I'm just not sure that there's any
2 defensible argument to say that comes from the theory;
3 it doesn't. It's informing on the empirical
4 motivations or the underlying incentives because it
5 doesn't.
6 And, so, I do think one of the -- and then
7 to say, well, you know, cereals, Chris did, it doesn't
8 show -- that's just one example, but I think the
9 theory says it should show up everywhere where there
10 are incentives.
11 And, so, I struggle with this because I
12 think if we really believe that common owners, that
13 asset management companies are behaving in this way or
14 their portfolio companies are interpreting this set of
15 incentives and responding to them, it should be
16 ubiquitous and we should be able to find places where
17 there is variation that would, like the cereals
18 variation, distinguish between these are similar,
19 large companies in this market and some small ones
20 over here that are dissimilar. We should be able to
21 look for places where we see what the theory predicts,
22 and the theory is richer than the tests have been so
23 far.
24 MR. SCHMALZ: So that's not the theory. I
25 think I've been very clear about this during the day.

1 The theory is not that anybody sits there and is a
2 puppet master. I'm not going to repeat all the points
3 I made this afternoon, but that was a
4 misrepresentation of what the theory is.
5 MR. WILSON: Okay, Serafin, do you want to
6 chime in? Fair enough.
7 All right, we are winding down, and so I
8 want to get to more of the questions from the
9 audience. And the first I want to tee up I think is
10 going to be extremely narrow insofar as it is directed
11 entirely to Serafin.
12 The Federal Reserve enters into passivity
13 agreements that limit voting by large asset managers.
14 How does your banking paper adjust voting rights?
15 MR. GRUNDL: So we don't adjust voting
16 rights in our paper. What the Fed does in general is
17 something I can't comment on here.
18 MR. WILSON: Okay. And to be honest, I
19 overlooked the fact that Martin was also an author of
20 banking papers. Do you adjust the issue of voting
21 rights?
22 MR. SCHMALZ: So I'm not perfectly
23 understanding the question. Is the question about the
24 10 percent limit the Fed imposes on asset managers,
25 like the reason Warren Buffett can't hold more than 10

1 percent in Wells Fargo? Is that the -- I'm not sure
2 precisely -- what precisely the question is.
3 AUDIENCE MEMBER: May I clarify the
4 question?
5 MR. WILSON: Yes.
6 AUDIENCE MEMBER: The Federal Reserve
7 requires that asset managers do not vote (off
8 microphone).
9 MR. SCHMALZ: Mm-hmm.
10 AUDIENCE MEMBER: So you've got a banking
11 paper that is predicated on (off microphone). How do
12 you adjust for that?
13 MR. SCHMALZ: So that's not adjusted at all.
14 AUDIENCE MEMBER: So the paper really is
15 based on (off microphone).
16 MR. SCHMALZ: No, the paper is based on a
17 model that is imperfect. It's based on data that's
18 imperfect. The question is if any of these
19 imperfections matter for the conclusions, and I don't
20 think we have evidence of that. If you're willing to
21 supply better voting data as the one you mentioned and
22 better than the regulatory filings, that would be very
23 useful to the research community.
24 MR. WILSON: Thanks. So this one is
25 directed to Martin and Dan. Professor Schmalz has

1 suggested that some of the criticism and responses to
2 his original airline paper actually confirm those
3 original paper's findings. And I guess the question
4 is about does Dan agree that his paper confirms
5 Martin's original findings?
6 MR. O'BRIEN: Yeah, so I agree that when we
7 run a regression, that's the same regression as
8 Martin, José, and Isabel's regression. We get the
9 same answer or pretty close, and the reason we did
10 that was to try to see if we had the same data set,
11 because if it's identical, we should get the same
12 thing.
13 So, now, we did not replicate -- I do not
14 agree that our analysis confirms their results at all.
15 The whole point of the paper was to say we don't think
16 this is the right methodology, and we adopted two
17 other methodologies that yield different answers.
18 They both yield the answer that common ownership did
19 not raise airfares.
20 MR. SCHMALZ: So the only -- I agree the
21 only thing this proves is probably our results were
22 not driven by a coding error, or we made the same one
23 or one with a similar effect.
24 MR. O'BRIEN: I agree with that.
25 MR. SCHMALZ: And any particular way in

1 which you'd treat one particular individual
2 shareholder's voting rights versus another is not
3 going to lead to the particular empirical results we
4 have. Differences in interpretation of these results
5 are completely -- I didn't mean to suggest that we
6 agree on that part.
7 MR. O'BRIEN: Yeah, so, Einer had a slide
8 up, too, that said we've confirmed their results.
9 That's just really an interesting observation.
10 MR. WILSON: Thanks. So I think moving on
11 to quite a different point, which is that vast
12 majority of the literature that Martin has summarized
13 has focused on listed U.S. actors. To what extent do
14 we think that there is scope for extending to consider
15 I guess non-U.S. data to see if this hypothesis holds
16 in other sectors and areas?
17 MR. SCHMALZ: Sorry, it's a question to me?
18 It's difficult to find ownership data and
19 product market data in general. Scandinavian
20 countries have good data, and then it relatively --
21 stops relatively quickly. So this call to action also
22 goes to competition authorities elsewhere to try and
23 make ownership data more accessible. In many cases,
24 they simply don't know who owns the firms they're
25 regulating, okay, so they can't even study these

1 questions. And for researchers, it's equally hard.
2 MR. WILSON: Just a factual followup
3 question for me. So the Scandinavian ownership data,
4 is that relatively easily accessible to researchers?
5 MR. SCHMALZ: There, you can match the
6 ownership of a firm with the personal records of the
7 owner. So it's pretty good in many cases.
8 MR. WILSON: That does seem pretty good.
9 MR. CONLON: As a counterexample, you know,
10 my favorite industry is chocolate confections. And,
11 so Hershey is publicly trade and Mondelez is publicly
12 traded on U.S. exchanges. Mars, the largest seller in
13 the U.S., is the third or fourth largest privately
14 held firm in the United States. You know, the family
15 mostly owns them, but the other firm is Nestle, which
16 is a Swiss firm. And it's been quite clear to me I'm
17 never going to get the data who owns Nestle stock.
18 MR. SCHMALZ: Or with other stocks the
19 Kelloggs Foundation owns, right? So this is just
20 extremely scant in terms of data.
21 MR. WILSON: Thanks. We are winding down.
22 I guess let's go for a lightning round of roughly one-
23 minute closing statements from the panel. Maybe let's
24 start with Nancy and work backwards.
25 MS. ROSE: Sure. So I'd like to make two

1 points about airlines that I think haven't been
2 flagged. So one was we've heard that we need the
3 enforcers to be investigating this. I would like to
4 point out that in 2015, the *Washington Post* reported
5 on a Department of Justice investigation of potential
6 capacity discipline and coordination among airlines.
7 The *Post* writes, "U.S. Airlines received a letter
8 Tuesday demanding copies of all communications between
9 carriers, their shareholders, and investment analysts
10 about their plans for limiting seat capacity."
11 In January of 2017, the national press
12 reported that that investigation did not seem to have
13 gone anywhere. I can't comment on it because I was at
14 the DOJ during that period, but those are two public
15 statements that you might just put into your fodder
16 about the likelihood that demanding all communications
17 between companies and their investors will shed a lot
18 of light on this phenomenon. That's all I have to say
19 about that aspect.
20 And the other I would say with respect to
21 airlines, another interesting episode for you to
22 perhaps take home with you and look at, Martin
23 mentioned that that airline continues to have
24 extraordinarily high levels of common ownership. I
25 would invite you to look at what's happened with

1 United Airline between 2016 and the middle of 2018
2 when United deviated from its previous low-capacity
3 growth rates that were common across the industry.
4 They had a couple of relatively small
5 investors, one of which owned a number of other
6 airlines, one of which only owned United, who pushed a
7 proxy fight, ended up with a board seat. United grew
8 much faster. It tanked a lot of the other airline
9 industry stocks in early 2018, I think it was, when
10 they announced they were going to pursue this --
11 continue to pursue this growth strategy, but it raised
12 United's fares.
13 And I think this is just an example if
14 there's a profitable deviation, if you can raise your
15 company's market value, companies are tempted to take
16 it, and the common owners didn't seem to block.
17 MR. WILSON: Thank you.
18 Chris.
19 MR. CONLON: All right, I’ve said most of
20 what I want to say, so I'm just going to do a quick
21 plug. In five weeks, Matt, my coauthor, and Mike
22 Sinkinson and I are going to be at Brookings unveiling
23 one of our three common ownership papers. So I think
24 it’s going to be -- I think they told us the 16th or
25 the 17th of January. So if you're in D.C. and you

1 want to hear more debates and discussions about common
2 ownership, hopefully we'll see you there.
3 MR. WILSON: Many thanks, Chris.
4 Martin.
5 MR. SCHMALZ: I just want to say that I have
6 no stakes or strong opinions about which particular
7 approach should be taken going forward in this
8 literature. There are many great minds who are
9 thinking about this question.
10 What I do want people to walk away with is
11 that just assuming, without evidence, that if two
12 firms’ shareholder base overlaps by 100 percent, that,
13 therefore, they are completely independent, that this
14 is just not something that is backed by either theory
15 nor the existing empirical evidence. So declaring
16 this a nonissue and an issue that regulators and
17 researchers shouldn't study strikes me as absurd.
18 MR. WILSON: Thank you.
19 Dan.
20 MR. O’BRIEN: Yeah, so, I'll say, so this is
21 all really interesting to me, having participated in
22 work on the theory years ago, and I think it's really,
23 you know, great that Martin and his coauthors kind of
24 took that and said what can we do with this and did a
25 bunch of empirical work, and that's great.

1 I think it's true that we don't have
2 evidence today that with respect to institutional
3 investors there's a problem with common ownership.
4 I do think there are -- we all agree that, you know,
5 some degree of common ownership could have
6 anticompetitive effects. And I think that's probably
7 quite testable in contexts that are simpler than the
8 institutional investor context and that I look forward
9 to more research that, you know, tells me whether or
10 not that model makes any sense.
11 MR. WILSON: Thank you.
12 Serafin.
13 MR. GRUNDL: Yeah, so perhaps a few words
14 about what I think the academic debate can deliver and
15 what it cannot deliver. So I think we can maybe reach
16 conclusions about what different methods, how the
17 results of different methods ought to be interpreted,
18 and there are going to be isolated empirical results
19 for certain industries, but if you want to kind of
20 settle the empirical matter, it cannot come out of the
21 academic literature, it has to be institutions, say at
22 like the FTC, that collects data from many industries
23 to kind of give a comprehensive view of whether there
24 is an effect and, if yes, how big it is.
25 MR. WILSON: Thank you. And with that, I'm

1 afraid the panel must come to a close. I thank you
2 all for your attention and for sticking around for
3 discussion.
4 (Applause.)
5 (Hearing concluded.)
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