PREPARED REMARKS

"Taking Stock: Assessing Common Ownership"

Noah Joshua Phillips
Commissioner
U.S. Federal Trade Commission

June 1, 2018
Concurrences Review and NYU Stern:
The Global Antitrust Economics Conference
New York City, New York

Introduction

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

Two important caveats:

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

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

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

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

Discussion about the antitrust implications of common ownership has moved quickly. Just a few years from the appearance beginning in 2014 of working papers showing potential price effects from common ownership, antitrust scholars identified an epochal and wide-ranging antitrust harm, an "economic blockbuster", according to Einer Elhauge; "the antitrust challenge of our time", according to Eric Posner, Fiona Scott Morton, and Glen Weyl.[1] Dramatic policy proposals followed. Posner, Scott Morton, and Weyl, for instance, propose limiting ownership stakes within a given industry to 1% unless the investor commits to "pure passivity" – which they admit would upend "the basic structure of the financial sector".[2]

This debate is not just academic. In December 2017, the OECD held hearings; and European antitrust enforcers have begun putting common ownership theory into practice.[3]

---

[1] Einer Elhauge, *Horizontal Shareholding*, 129 HARV. L. REV. 1267, 1267 (2016); Eric A. Posner, Fiona M. Scott Morton & E. Glen Weyl, *A Proposal to Limit the Anticompetitive Power of Institutional Investors*, 81 ANTITRUST L.J. 669, 670 (2017).

[2] Posner, Scott Morton & Weyl at 715.

[3] *See* Case M.7932 – Dow/DuPont, European Commission DG Competition, Commission Decision of 27.3.2017 declaring a concentration to be compatible with the internal market and the EEA Agreement, § 8.6.4-8.6.5,

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

> Given the ongoing academic and research debate, and its early stage of development, the U.S. antitrust agencies are not prepared at this time to make any changes to their policies or practices with respect to common ownership by institutional investors.[4]

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

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

The Empirics, and the Evidence

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

---

http://ec.europa.eu/competition/mergers/cases/decisions/m7932_13668_3.pdf ("[A]s for current price competition, the presence of significant common shareholding is likely to negatively affect the benefits of innovation competition for firms subject to this common shareholding."); Martin C. Schmalz, *Common Ownership and Competition: Facts, Misconceptions, and What to Do About It*, OECD Hearing on Common Ownership by Institutional Investors and Its Impact on Competition, ¶ 3.4 ("Competition authorities should track (common) ownership of firms. Several national competition authorities have already begun to do so, as illustrated in the OECD background paper."). *See also* Margrethe Vestager, European Commissioner for Competition, *Competition in Changing Times*, FIW Symposium, Innsbruck, Austria (Feb. 16, 2018), https://ec.europa.eu/commission/commissioners/2014-2019/vestager/announcements/competition-changing-times-0_en ("We need to look closely at what actually happens – whether [common shareholders] can really get companies to compete less hard.").

[4] US submission to OECD Hearing on Common Ownership by institutional investors and its impact on competition (28 Nov. 2017).

Isabel Tecu and Sahil Raina have made an important contribution to economic scholarship, and the conversation we are having attests to that. [5]

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

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

---

[5] José Azar, Martin C. Schmalz & Isabel Tecu, *Anticompetitive Effects of Common Ownership*, 73(4) J. FIN. 1 (2018); José Azar, Sahil Raina & Martin C. Schmalz, *Ultimate Ownership and Bank Competition* (Jul. 23, 2016), http://ssrn.com/abstract=2710252.

[6] *See, e.g.*, Daniel P. O'Brien & Keither Waehrer, *The Competitive Effects of Common Ownership: We Know Less than We Think*, 81 ANTITRUST L.J. 729, 744-48 (2017); Edward B. Rock & Daniel L. Rubinfeld, *Defusing the Antitrust Threat to Institutional Investor Involvement in Corporate Governance*, NYU Law and Economics Research Paper No. 17-05, at 8 (2017), https://ssrn.com/abstract=2925855; Douglas H. Ginsburg & Keith Klovers, *Common Sense about Common Ownership*, 2-2018 Concurrences, at 14 & n.59; Patrick Dennis, Kristopher Gerardi, & Carola Schenone, *Common Ownership Does Not Have Anti-Competitive Effects in the Airline Industry* (Feb. 5, 2018), https://ssrn.com/abstract=3063465 ("empirically analyze[d] the relationship between ticket prices and common ownership in the airline industry" and "[i]n sharp contrast to the findings in Azar, Schmalz, and Tecu (2017), [found] no evidence of such a relationship"); Pauline Kennedy, Danial P. O'Brien, Minjae Song, and Keith Waehrer, *The Competitive Effects of Common Ownership: Economic Foundations and Empirical Evidence* (Jul. 24, 2017), https://ssrn.com/abstract=3008331 (found "no evidence that common ownership raises airline prices", and its "estimates reject[ed] a null hypothesis of proportional control"); Jacob Gramlich and Serafin Grundl, *Estimating the Competitive Effects of Common Ownership*, Finance and Economics Discussion Series 2017-029 (Apr. 21, 2017), https://doi.org/10.17016/FEDS.2017.029r1.

an anticompetitive harm in any given market.[7] The facts matter tremendously here, so we need more information about other industries to draw conclusions about how common ownership might affect competition across the economy as a whole.

The robust debate about common ownership, and its implications for antitrust, will continue, and we will see where things eventually land. But scholars on all sides do appear to agree on one important point today: the available evidence does not identify a clear mechanism by which common shareholding actually causes a lessening of competition. Even staunch believers in the common ownership story acknowledge that they have not clearly identified one.[8] Some argue such a showing is not necessary, a point I will address later.[9] But others offer hypotheses as to the mechanism – and even policy prescriptions to stop it – just not evidence.[10]

The large institutional investors do not appear to be at the apex of a massive antitrust conspiracy. They do not appear to be encouraging portfolio companies to lighten up on competition,[11] nor eliciting from them confidential information which

---

[7] Menesh S. Patel, *Common Ownership, Institutional Investors, and Antitrust*, ANTITRUST L.J. (forthcoming).

[8] Fiona Scott Morton & Herbert Hovenkamp, *Horizontal Shareholding and Antitrust Policy*, 127 YALE L.J. 2026, 2031 (2018) ("The theory literature to date does not identify what mechanism funds may use to soften competition.").

[9] Jose Azar, Martin Schmalz & Isabel Tecu, *Why Common Ownership Creates Antitrust Risks*, COMPETITION POLICY INTERNATIONAL, at 6 (Jun. 14, 2017), https://www.competitionpolicyinternational.com/wp-content/uploads/2017/06/CPI-Azar-Schmalz-Tecu.pdf.

[10] Some have offered remedial proposals that include common investors agree to "pure passivity"; that pure passivity would alleviate the antitrust harm presumes some affirmative actions were the cause. *See* Elhauge at 1269-70; Posner, Scott Morton & Weyl; *see also* Scott Morton & Hovenkamp at 5 (articulating potential mechanisms).

[11] Some have suggested that common owners might vote their shares in favor of lax competition and point to work that indicates horizontal shareholding negatively correlates with forms of executive compensation that reward surpassing rivals' performance. *See* Miguel Anton, Florian Ederer, Mireia Gine, & Martin C. Schmalz, *Common Ownership, Competition, and Top Management Incentives* Ross School of Business Paper No. 1328; European Corporate Governance Institute (ECGI) - Finance Working Paper No. 511/2017 (Jun. 1, 2017), https://ssrn.com/abstract=2802332. Generally, it is

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

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

A Counter-Intuitive Intuition

For these reasons, much of the common ownership debate focuses on confirming or disputing the core intuition behind the theory of harm – *i.e.*, that corporate managers, cognizant that their large institutional shareholders also hold stock in competitors, soften competition to benefit those shareholders. That is the fundamental claim underlying the common ownership debate.

The problem is, as intuitions go, it is rather counter-intuitive. Scholars have noted several ways in which this is so, and today I want to tease out one in particular. That is, the theory of corporate behavior underlying the harm from common ownership runs contrary – directly contrary – to our ancient and well-established concerns about the relationship between managers and shareholders.

---

unclear how such preferences would or could be communicated through shareholder voting. Rock & Rubinfeld at 17 ("In sum, there is no obvious way in which shareholders can vote for 'soft competition.' . . . Since 2011, [] shareholders periodically (usually annually) have a non-binding 'say on pay' vote covering all aspects of compensation for top executives. Overall, 'say on pay' proposals are approved 92% of the time and there is little reason to think it provides a channel for any sort of fine tuning of executive compensation."). Voting for executive compensation plans that lowers managers' incentives to beat their rivals might be one mechanism, but some work finds precisely the opposite. *See* Heung Jin Kwon, *Executive Compensation under Common Ownership* (Nov. 29, 2016), http://fmaconferences.org/Boston/ExecutiveCompensationunderCommonOwnership.pdf ("At face value, the findings indicate that compensation is not the channel between common ownership and anti-competitive outcomes in product market.").

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

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

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

And, in the 1970s, Michael Jensen and William Meckling wrote a paper that defined modern corporate legal scholarship.[13] The principal problem (pun intended) they addressed – like Smith, Berle, Means and others before them – was the cost of agency, that is, the problem of aligning the incentives of the principal – the shareholders of a corporation – with their agents – management. The existence of the problem was nothing new then, and it remains with us today. The distinction between ownership and control is fundamental, and fundamentally problematic. But not in the direction that would reinforce the common ownership story.

For centuries, literally, we have concerned ourselves with the problem of making managers care more about shareholders – precisely because there are

---

[12] Adam Smith, The Wealth of Nations 700 (Cannan ed., Modern Library 1937) (1776).
[13] Michael Jensen & William Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3(4) J. FIN. ECON. 305 (1976).

innumerable reasons to fear that they do not. Yet the common ownership story rests squarely on the belief that managers care quite a bit about some shareholders, specifically those who hold shares in competitors, and quite a bit less about others.

Consider this: it is a fundamental precept of corporate law that, "[i]n carrying out their managerial roles, directors are charged with an unyielding fiduciary duty to the corporation and its shareholders" – not a particular subset thereof.[14] In the real world, however, agency costs are serious concerns, and managers have incentives that may not accord with these duties.[15] So, we have laws that help guide them. Managers simply may not take care – that is, they may exhibit the negligence about which Adam Smith worried. That concern animates the "duty of care" at the heart of the legal regime for corporate managers. Managers may also seek to enrich themselves. That animates the "duty of loyalty." They may defraud shareholders, a risk our securities laws operate to prevent.[16] The list goes on, but the point remains: managers have such strong, demonstrated, incentives to derogate from their duties to shareholders that we have erected robust common law and statutory regimes to keep them from doing so.

We have seen many cases where managers failed shareholders generally. And we have seen cases where management – or others – favored the majority over the minority. The takeover fights of the 1970s and 1980s were rife with such

[14] *Smith v. Van Gorkum*, 488 A. 2d 858, 872 (Del. 1985).
[15] Betrand & Mullainathan, *Enjoying the Quiet Life? Corporate Governance and Managerial Preferences*, 111(5) J. POL. ECON. 1043 (2003) (examining outcomes from state level changes in anti-takeover laws and finding that when insulated from takeovers, profits and productivity decline.).
[16] Joel Seligman, The Transformation of Wall Street (3d ed. 2003) (1982).

behavior.[17] But I am not aware of a demonstrated tendency of management to favor a particular set of minority shareholders without some other incentive. (Management favoring their own holdings, which may be the minority, would be a different matter.)

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

The common ownership story may, in fact, require managers to put shareholder interests over their own financial well-being. While some work points to the fact that managers are frequently paid in ways that reward industry performance,[18] they are also paid on firm profitability. And recent research indicates that institutional investors may, in fact, push executive compensation away from alignment with industry performance.[19] That is the precise opposite of what the common ownership story would lead one to predict. Consider also the market for managerial jobs. It is easy to market success where the firm you ran bests its competitors; much harder to earn that reputational reward from presiding

[17] *See, e.g., Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985).
[18] Elhauge at 1278.
[19] *See* Kwon; *contra* Anton et al.

over a lessening of competition in a particular industry, which only one or a few shareholders see.[20]

The institutional investors lens does not seem to change the picture. By orienting firm strategy according to their particular interests, the common ownership story treats institutional shareholders more like joint venturers, perhaps like participants in Adam Smith's "copartnery". As noted earlier, antitrust law has long had a lot to say about that. But, as the agency cost story tells us, shareholders are not partners.

Why would management work (or not work) specifically on behalf of the common owner institutional investors? The answer might be that they are the biggest shareholders: they vote en bloc (generally[21]); listen in on earnings calls, etc. The first problem with this answer is that there is insufficient evidence to indicate that management consider the well-being of shareholders in proportion to their holdings. There is no robust link between minority ownership and control.[22] The second problem is that experience teaches that, notwithstanding their size,

---

[20] Lambert & Sykuta, *The Case for Doing Nothing About Institutional Investors' Common Ownership of Small Stakes in Competing Firms*, University of Missouri School of Law Legal Studies Research Paper No. 2018-21, at 21 (2018) ("As sellers in the market for managerial talent, corporate managers benefit from reputations for business success, and they can best establish such reputations by beating (usurping business from) their industry rivals.").

[21] *But see* Ginsburg & Klovers, *supra* note 6, at 9-11 ("For example, BlackRock split its vote in a recent contested proxy contest involving Proctor & Gamble, with some of its actively managed funds voting for the management proposal and others of its actively managed funds and its index funds voting against it."), & n.47 (citing Eric Rosenbaum, *Exxon Mobile Loses Support of A Powerful Voice in Climate Change Policy*, CNBC.COM (Aug. 31, 2017), https://www.cnbc.com/2017/08/31/investing-power-vanguard-votes-against-exxonmobil-on-climate-change.html ("characterizing State Street as 'the strongest voice among investing giants' in supporting climate change proposals, BlackRock as an active supporter, and Vanguard as generally opposed with a few recent exceptions")).

[22] Law & Economics Center, *George Mason Law Review's 21st Annual Antitrust Symposium,* Antonin Scalia Law School (Feb. 16, 2018), http://masonlec.org/events/george-mason-law-reviews-21st-annual-antitrust-symposium/; *see also* O'Brien and Waehrer.

institutional investors do not exercise a great deal of control. Scholars of corporate law have more often criticized such companies for not asserting their interests enough.[23] Chancellor Leo E. Strine, Jr., of the Delaware Court of Chancery, lamented in 2014 that "the reality is that the segment of the investment community that is best positioned to vote with an eye toward sustainable value creation is the least active in exercising voice and judgment in American corporate governance: index funds."[24] Lucian Bebchuk and others have observed that, in many respects, the power dynamic works in the opposite direction, leading them to conclude that "it is implausible to expect that index fund managers would seek to facilitate significant anticompetitive behavior".[25]

Given the persistent and sometimes troublesome divide between ownership and control within a corporation, practitioners and scholars have long placed great hope in institutional investors. Finally, someone with the economic incentive and the financial wherewithal to police corporate managers! But the point is that they have been disappointed, which raises the question why managers would, in this case, orient firm competition to suit their particular interests.

---

[23] *See* Dorothy S. Lund, *The Case Against Passive Shareholder Voting*, J. CORP. LAW (forthcoming) ("[M]any passive funds are likely to leave company performance to the invisible hand of the marketplace. Even if a fund does choose to intervene, it will rationally adhere to a low-cost, one-size-fits-all approach to governance that is unlikely to be in the company's best interest."); Lucian A. Bebchuk, Alma Cohen & Scott Hirst, *The Agency Problems of Institutional Investors*, 31 J. ECON. PERSP. 89, 110 (2017) ("An understanding of agency problems of institutional investors leads to the conclusion that modern corporations do not suffer from too much shareholder intervention, but rather from too little.").
[24] Leo E. Strine, Jr., *Can We Do Better by Ordinary Investors? A Pragmatic Reaction to the Dueling Ideological Mythologists of Corporate Law*, 114(2) COLUMBIA L. REV. 449, 477 (2014).
[25] Bebchuk, Cohen & Hirst at 108-09.

There is evidence that institutional investors have exerted pressure to make gains for shareholders broadly. For instance, research has found institutional investors enhance productivity, managerial efficiency, and financial disclosure.[26] Recent research also shows that passive institutional ownership has improved firms' governance and long-term performance.[27] And, of course, institutional investors offer products that make investing easy and cheap, so that even people without much money can diversify and avoid risk – in the case of index funds, frequently outperforming actively managed equity mutual funds.[28] These are real consumer benefits for which our discussion (and any antitrust policy decisions) must account.

The fundamental assumption that all shareholders of an institutional common owner will benefit from softening competition is also debatable. Many of these shares are held in index funds, for instance, where gross returns across institutions are nearly identical and competition is over management fees, index tracking, etc.[29] And, given the diversity of holdings of large institutional investors,

---

[26] Philippe Aghion, John Van Reenan & Luigi Zingales, *Innovation and Institutional Ownership*, 103(1) AM. ECON. REV. 277 (2013) (productivity); Ghasan A. Baghdadi, Ishaq M. Bhatti, Lily H.G. Nguyen & Edward J. Podolski, *Skill or effort? Institutional ownership and managerial efficiency*, 91 J. BANK. & FIN. 19 (2018) (managerial efficiency); Audra L. Boone & Joshua T. White, *The effect of institutional ownership on firm transparency and information production*, 117 J. FIN. ECON. 508 (2015) (financial disclosure).
[27] Ian Appel, Todd Gormley, and Donald Keim. *Passive Investors not Passive Owners*, J. FIN. ECON. (forthcoming).
[28] See Bebchuk, Cohen & Hirst at 94 (citing Kenneth R. French, *Presidential Address: The Cost of Active Investing*, 63 J. FIN. 1537 (2008); Burton G. Malkiel, *The Efficient Market Hypothesis and Its Critics*, 17 J. ECON. PERSP. 59, 77 (2003) ("A remarkably large body of evidence suggests that professional investment managers are not able to outperform index funds that buy and hold the broad stock market portfolio.").
[29] Rock & Rubinfeld at 7; Lambert & Sykuta at 19-20.

other companies in their portfolio, which do business with the commonly-owned competitors, may experience negative price effects of common ownership.[30]

Our experience with corporate managers and institutional investors runs counter to the common ownership story, and may explain the absence of a clear mechanism of harm.

As I noted earlier, however, Azar, Tecu and Schmalz claim the harm mechanism may simply be one of omission – that is, that common owners do not advocate sufficiently for competition, leading to less of it. If the harm is indeed "an absence of incentives to compete" because shareholders do not affirmatively push for competition, then it would seem we have a much larger problem than common ownership.[31] As Berle and Means long ago recognized, dispersing ownership among numerous shareholders itself reduces the ability and incentive of any given shareholder to exert control, such as by pressuring the firm to compete more aggressively. So if our problem is that common shareholders do not exert enough procompetitive pressure on the firm, but our alternative is further to disperse shareholdings (or to encourage large investors to be "purely passive"), we might not be gaining any increase in competition – and we might risk losing the benefits of institutional investors.

[30] *See* Robert G. Hansen & John R. Lott, Jr., *Externalities and Corporate Objectives in a World with Diversified Shareholder/Consumers*, 31 J. FIN. & QUANTITATIVE ANALYSIS 43 (1996).
[31] Azar, Schmalz & Tecu, *Antitrust Risks*, at 6 (emphasis omitted).

Conclusion

This debate over common ownership has raised interesting questions and increased our level of awareness. The FTC has engaged in and helped to facilitate this important discussion, and I hope it will continue to do so. I am interested, in particular, to see how common ownership impacts a broad set of industries, whether a clear mechanism of harm can be identified, a rationale why managers put the interests of one set of shareholders above the others and a rigorous weighing of the pro-competitive effects of institutional shareholding.

For now, I do not believe we know enough to warrant policy changes. U.S. antitrust enforcers have tools already at our disposal for monitoring and disciplining anticompetitive activity, and will use those tools to intervene where the law and the evidence provide a basis for doing so.

Calls to change the enforcement of antitrust law are being made these days as frequently and loudly as they have been in my lifetime. In such an environment, and especially when proposals for change put at risk both shareholder value and consumer benefits, we as enforcers must tread carefully and you as scholars must continue your very important work.

Thank you.