CHAMBER OF COMMERCE
OF THE
UNITED STATES OF AMERICA

January 18, 2019

Office of the Secretary
Federal Trade Commission
600 Pennsylvania Avenue NW.
Suite CC-5610 (Annex C)
Washington, DC 20580

Submitted electronically via regulations.gov

RE: Competition and Consumer Protection in the 21st Century Hearing #8, Subject: Common Ownership

Dear Commissioners:

The U.S. Chamber of Commerce appreciates the opportunity to comment on the Federal Trade Commission's ("FTC" or "Commission") "Competition and Consumer Protection in the 21st Century Hearing #8," with a focus on common ownership ("FTC's hearing #8"). The Chamber urges the Commission to avoid unwarranted and hasty changes in policy in response to the theoretical, academic arguments regarding the unproven, debatable theory that common ownership produces anti-competitive effects. We are concerned that the policy proposals suggested by certain commentators during the FTC's hearing #8 would harm consumers and businesses' access to capital.

The Chamber believes that any change in antitrust policy, especially one that would impose significant costs and burdens on millions of Americans, requires demonstrable evidence that common ownership has anti-competitive effects. To date, the economic research is theoretical and the econometric methods used by initial studies are being debated. As a result, we believe that the existing state of the literature falls short of the standard of harm found in U.S. antitrust law.

Researchers have found significant flaws in the initial research asserting anti-competitive effects from common ownership.

Initial research asserting anti-competitive effects in the airline and banking industries arising from common ownership has attracted considerable attention. Subsequent research has found flaws in the methodology of the original research. In contrast to the initial findings, this later research has found no anti-competitive effects of common ownership. In this section, we have provided a brief overview of some of the academic research that has come to different conclusions than those of the original researchers on common ownership. We believe it is important to highlight the ongoing academic debate for the record, as several of the commentators at the FTC's hearing #8 made inaccurate statements suggesting that the results of initial studies on common ownership are "uncontested."

Daniel O'Brien, Executive Vice President of Compass Lexecon and former Deputy Director of the FTC's Bureau of Economics was a pioneer in developing the Modified Herfindahl-Hirschmann Index (MHHI)[1]—the methodology underpinning the initial research finding anti-competitive effects from common ownership. O'Brien developed the MHHI to study partial ownership, which differs in important ways from common ownership. Partial ownership occurs when "one or more competing firms purchase some percentage of a rival firm's stock, or when two or more firms jointly invest in a venture that competes in the same market."[2]

In contrast, common ownership occurs when institutional investors with non-controlling interests in one company have non-controlling stakes in other companies in the same industry. During the FTC's hearing #8, O'Brien questioned the application of the MHHI methodology to common ownership. Specifically, he commented that assumptions around: (1) proportional control weights for investors with non-controlling interests, (2) the selection of airlines as the relevant common ownership group, and (3) an incomplete understanding of institutional investors'

[1] O'Brien, Daniel, and Steven Salop, "Competitive Effects of Partial Ownership: Financial Interest and Corporate Control," *Antitrust Law Journal*, 67, no. 3 (2000): 559-614.
[2] O'Brien, Daniel, and Steven Salop, "Competitive Effects of Partial Ownership: Financial Interest and Corporate Control," *Antitrust Law Journal*, 67, no. 3 (2000): 559-614 at 560.

incentives "raise troubling issues for using the theory of partial ownership to assess the competitive effects of common ownership by institutional investors."[3] O'Brien further stated, "We do not currently have theoretical or empirical evidence that 'macro-level' common ownership, as occurs through institutional investors, is likely to harm competition."

O'Brien's comments echoed the remarks of FTC Commissioner Noah Phillips at the FTC's hearing #8, who highlighted that "Common ownership is distinct from cross ownership."[4] Phillips referenced an OECD definition of common ownership, which is "the simultaneous ownership of stock in competing companies by a single investor where none of these stock holdings is large enough to give the owner control of any of these companies." Commissioner Phillips also highlighted that "Large institutional investors have, in many ways, made investing affordable for the average American."[5] Commissioner Phillips also commented on existing corporate and securities laws, noting that the assumptions underlying common ownership conflict with these existing laws. He stated, "Common ownership presumes that managers are very particularly attuned to the desires of a minority of their shareholders and act to maximize value to them, whereas corporate law assumes that managers, unless forced to behave otherwise, will act to maximize their own interests over that of shareholders generally and of minority shareholders specifically." In other words, common ownership theories contradict the entire basis of existing legal regimes.

Nancy Rose, the Department Head and Charles P. Kindleberger Professor of Applied Economics in the Massachusetts Institute of Technology Economics Department, also discussed the shortcomings of using the MHHI methodology for common ownership at the FTC's hearing #8. She noted that it does not measure behavior or correctly reflect market participants' incentives and cautioned that a rush to policy judgment would be premature. Likewise, Christopher Conlon, Assistant Professor of Economics at the New York University Stern School of Business,

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[3] https://www.ftc.gov/system/files/documents/public_events/1422929/cpc-hearings-nyu_12-6-18.pdf at 41

[4] https://www.ftc.gov/system/files/documents/public_events/1422929/ftc_hearings_session_8_transcript_12-6-18.pdf at 8 lines 12-15.

[5] https://www.ftc.gov/system/files/documents/public_events/1422929/ftc_hearings_session_8_transcript_12-6-18.pdf

highlighted the challenges with SEC Form 13F filings that were relied upon in the original common ownership literature, stating that "the data on common ownership are…unusually bad."[6] He conducted extensive testing of the common ownership theory and concluded that the "focus should be on profit weights, not MHHI."

Numerous other academic studies have corrected for the methodological and theoretical flaws in the original common ownership research and have concluded that common ownership does not produce anticompetitive effects, and some studies have even concluded that common ownership promotes competitive outcomes. For example:

- **Bebchuk and Hirst (2018):** "Common ownership concerns are a red herring that distracts anti-trust officials by unnecessarily refocusing their attention on ownership patterns and the stewardship of index fund managers."[7]

- **Dennis, Gerardi, and Schenone (2018):** "This paper questions the applicability of the theory of horizontal mergers and cross-ownership theory on the context of common ownership, and empirically analyzes the relationship between ticket prices and common ownership in the airline industry. In sharp contrast to the findings in Azar, Schmalz, and Tecu (2017), we find no evidence of such a relationship."[8]

- **O'Brian and Waehrer (2017):** When measuring the causal relationship between common ownership and prices charged by companies, O'Brian and Waehrer (2017)[9] found no correlation.

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[6] https://www.ftc.gov/system/files/documents/public_events/1422929/ftc_hearings_session_8_transcript_12-6-18.pdf at 305 lines 11-12.

[7] Lucian Bebchuk and Scott Hirst, "Index Funds and the Future of Corporate Governance: Theory, Evidence, and Policy," November 28, 2018

[8] Carola Schenone, Patrick J. Dennis, and Kristopher Gerardi, "Common Ownership Does Not Have Anti-Competitive Effects in the Airline Industry," January 2018.

[9] Daniel P. O'Brien and Keith Waehrer, "The Competitive Effects of Common Ownership: We Know Less Than We Think," February 22, 2017.

- **Kennedy, O'Brien, Song, and Waehrer (2017):** "Using data from the airline industry, we estimate the effects of common ownership on airline prices using price regressions and a structural oligopoly model consistent with the theory of partial ownership proposed in O'Brien and Salop (2000). Contrary to recent empirical research based on the same data, we find no evidence that common ownership raises airline prices."[10]

- **Buckberg, Herscovici, Jovanovic, Reitzes (2017)**: "We believe that the empirical literature cited by Posner et al. in support of competitive harm from horizontal shareholding is far from definitive and suffers from potential flaws. As such, there are doubts whether horizontal shareholding creates a competitive problem that justifies invoking a particular blanket "remedy," as opposed to a case-by-case analysis and more selective remediation. Analysis of the costs of the proposed blanket solution, which may be substantial…is lacking."[11]

- **Kwon (2016):** "This paper shows that higher common ownership of natural competitors is associated with more use of relative performance evaluation (RPE)...These findings suggest that institutional investors with common ownership exert a strong influence on executive compensation in a positive way: less alignment of pay with industry performance."[12]

No causal mechanism for common ownership to produce anti-competitive effects has been identified.

Putting aside the flawed methodology applied in the research purporting to find anti-competitive effects from common ownership, no causal mechanism to explain the econometric results has been identified. Both Noah Phillips, Commissioner of the FTC and Robert Jackson, Commissioner of the Securities and Exchange Commission ("SEC") expressed this view at the FTC's hearing #8. SEC

[10] Pauline Kennedy, Daniel P. O'Brien, Minjae Song, and Keith Waehrer, "The Competitive Effects of Common Ownership: Economic Foundations and Empirical Evidence," July 2017.
[11] Elaine Buckberg, Steven Herscovici, Branko Jovanovic, and James Reitzes, "Proposal to Remedy Horizontal Shareholding is Flawed," July 1, 2017.
[12] Heung Jin Kwon, Department of Economics, University of Chicago, "Executive Compensation under Common Ownership," November 29, 2016.

Commissioner Robert Jackson stated, "The literature does not yet identify a convincing causal mechanism through which concentrated common owners could achieve anticompetitive ends."[13] Additionally, earlier this year Commissioner Phillips reviewed the research on common ownership in thoughtful remarks entitled "Taking Stock: Assessing Common Ownership," presented at The Global Antitrust Economics Conference in June 2018. He concluded: "For now, I do not believe we know enough to warrant policy changes."[14]

Non-controlling shareholders do not have the ability to influence competition.

Even if common owners had the incentive to affect performance in an industry, they would not have the ability to do so since shareholders do not have the opportunity to vote on competition strategy. Traditionally, company CEOs and management make ordinary business decisions, including pricing strategy, and subsequently Boards of Directors act as the first line of defense in holding management accountable. Public voting records have shown this and a paper by Professor Anjan Thakor[15] notes, "Competitive strategy is entirely within the purview of management and most of the time not subject to any kind of public disclosure or debate."

Institutional investors engage on a number of corporate governance issues, such as Board composition, executive compensation, and management performance. Engagement with shareholders allows management to communicate with their shareholder base as they implement strategies to generate long-term growth. According to the Chamber's most recent annual proxy survey, nearly 80% of companies report that they have some type of year-round regular communication program with institutional investors.[16] However, as noted by several industry

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[13] Robert J. Jackson Jr., "Common Ownership: The Investor Protection Challenge of the 21st Century," December 6, 2018

[14] Noah Joshua Phillips, "Taking Stock: Assessing Common Ownership," June 1, 2018.

[15] "The Economic Consequences of Regulatory Protection and Extraterritorial Reach," commissioned by CCMC, written by Professor Anjan V. Thakor, European Corporate Governance Institute, Financial Theory Group Fellow, and John. E. Simon Professor of Finance at Washington University, Olin School of Business

[16] https://www.centerforcapitalmarkets.com/wp-content/uploads/2018/10/ProxySeasonSurvey_v3_Digital.pdf

participants at the FTC's hearing #8, institutional investors do not vote on pricing. Institutional investors are engaging on issues that help increase the long-term shareholder value of a company. Effective and transparent corporate governance systems that encourage shareholder communication and participation are critical for public companies to grow and compete.

If a single investor owned a controlling share in all the firms in an industry, competition would likely soften. However, common owners with a non-controlling interest would have no opportunity to reduce competition. Even if they did, companies would likely defer to the bulk of their shareholders who are not intra-industry diversified, and those shareholders would likely prefer that the companies maximize their own profits, rather than industry profits.[17]

Asset managers have a fiduciary duty to *all* of their clients and act on their behalf. Attempting to influence anti-competitive results in an industry would go against this duty.

Asset managers' common ownership has been a focal point of some researchers. However, asset managers do not invest on their own behalf and are accountable to all of their clients—not just those with common ownership shares. Not only do they not have an incentive to attempt to influence the performance of a particular industry, it would go against their fiduciary duty to their clients.

Asset managers operate under an agency business model and are not the economic owners of the assets they invest on behalf of their clients. Rather, the assets belong to institutions and individuals who are their clients (i.e., the "asset owners"). The investment results directly benefit the asset owners. Ginsburg and Klovers (2018) note this misconception among researchers in favor of limiting common ownership: "We believe the argument for antitrust enforcement against common ownership is misguided. First, proponents conflate management by investment managers and

[17] Thomas A. Lambert and Michael E. Sykuta, University of Missouri School of Law, "The Case for Doing Nothing About Institutional Investors' Common Ownership of Small Stakes in Competing Firms," May 2018 ("Lambert and Sykuta (2018)")

economic ownership by individual account holders and therefore incorrectly attribute allegedly anticompetitive conduct to the investment managers."[18]

Lambert and Sykuta (2018) point to Vanguard's minority ownership of American, Delta, Southwest, and United airlines and note that different competitive outcomes would be better for different Vanguard funds: "Vanguard's total ownership of each airline is divided among its many funds. Investors in those individual funds would have divergent preferences as to whether the airlines should maximize industry or own-firm profits and, if the latter, which airlines' profits should be maximized." Essentially, returns to retail investors depend on fund performance and the competitive outcome that maximizes retail investors' profits will differ among funds.

Limiting common ownership would increase the costs of investment products for retail investors, including retirees and investors saving for retirement.

Proposals to limit common ownership in a variety of ways, including through changes to existing antitrust laws or new regulation, would limit institutional investors' and mutual funds' abilities to diversify their holdings, which ultimately could increase retail investors' costs and risks.

As noted by O'Brien and Waehrer (2017),[19] "Institutional investors (e.g., mutual funds) frequently take positions in multiple firms in an industry in order to offer diversified portfolios to retail investors at low transaction costs. A change in antitrust or regulatory policy toward these investments could have significant negative implications for the types of investments currently available to retail investors."

Lambert and Sykuta (2018) echo similar concerns: "The policy solutions that have been proposed for dealing with the purported problem would radically rework an industry that has provided substantial benefits to investors, raising the costs of portfolio diversification and enhancing agency costs at public companies."

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[19] Daniel P. O'Brien and Keith Waehrer, "The Competitive Effects of Common Ownership: We Know Less Than We Think," February 22, 2017.

Industry participants, including the AFL-CIO and Council of Institutional Investors, as well as researchers and lawyers at the FTC's hearing #8 agreed that limiting common ownership would impact the ability of institutional investors to appropriately diversify their portfolios and would therefore increase the cost of investing for retail investors who rely on diversified investment products like index funds and mutual funds to save for retirement and other important financial needs. As SEC Commissioner Jackson put it, these policy solutions would "impose costly limitations on the diversified investments that American families count on to fund their education and retirement."[20] Given the preliminary nature of existing research findings related to common ownership, we believe it would be highly misguided for the FTC or any other government body to implement these policy remedies, as they would undermine the financial security of millions of Americans.

Limiting common ownership would impede capital formation.

Index investors play a key role in generating economic growth and job creation. Being part of an index is important to driving liquidity and access to capital for all companies, but particularly for smaller public companies. There has been a sharp decline in the number of public companies over the past two decades and smaller companies cite liquidity availability as a critical concern. With the rise of diversified asset management products and index investing, particularly among retail investors saving through retirement plans or through personal investment accounts, this has become an important source of long-term capital for smaller and newly public companies. Limiting funds to invest in one company per sector, as one of the academic proposals lays out, would be the equivalent of picking winners and losers and would inevitably affect smaller companies, likely leading to billions of dollars of divestment from many companies in that sector.

The Treasury report on Capital Markets already notes the benefits that smaller public companies believe they receive through investments by mutual funds and inclusion in market indexes.[21] Policy proposals that limit the amount of companies

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[20] Robert J. Jackson Jr., "Common Ownership: The Investor Protection Challenge of the 21st Century," December 6, 2018

[21] https://www.treasury.gov/press-center/press-releases/documents/a-financial-system-capital-markets-final-final.pdf

that mutual funds are permitted to invest in within a particular sector would, therefore, eliminate an avenue of capital formation for many companies and likely lead to divestments by mutual funds and other types of diversified investment products—both those managed by asset managers and those managed directly by asset owners (e.g., pension plans). As noted by David Hirschmann, President and CEO of the Chamber's Center for Capital Markets Competitiveness, at the FTC's hearing #8, "If the government places undue restrictions on investments in public companies, it would further discourage companies from going and staying public." The declining number of public companies and the disincentives to going public have been echoed on numerous occasions by SEC Chairman Jay Clayton and Members of Congress as a significant policy issue.

Limiting voting rights for common owners would cause a misrepresentation of majority shareholder views.

Some researchers have proposed eliminating the voting rights of common owners. This would eliminate the ability of a large number of shareholders to exercise their right to vote proxies at public companies in which they are a shareholder on important corporate governance issues, which would dilute the views of long-term shareholders and could empower certain minority shareholders whose interests may not be aligned with those of the majority of shareholders. For instance, a small group of activists is responsible for a significant proportion of all shareholder proposals. During 2017, just three individuals and their family members sponsored 25% of proposals submitted at the Fortune 250.[22] We believe that disenfranchising common owners would likely embolden these types of activist campaigns.

Additionally, much of the research on common ownership ignores the influence of proxy advisory firms, which in many cases can have more influence than the biggest asset manager investors in a company. For example, a 2018 Manhattan Institute report found that a proxy advisor recommendation can affect a vote by 15-30%.[23] Proposals to limit voting rights of common owners or to limit the ability of

[22] Proxy Monitor 2017: Season Review, available at https://www.manhattan-institute.org/html/proxy-monitor-2017-season-review-10757.html
[23] https://www.manhattan-institute.org/sites/default/files/R-JC-0518-v2.pdf

these investors to conduct shareholder engagement activities will only empower these minority investors and proxy advisory firms further.

Conclusion

The Committee on Capital Markets Regulation found that "the economic results of the common ownership research have now been countered by subsequent academic studies, and antitrust analysis based on the early research has been premature. No solutions are necessary to a problem that has not yet been proven to exist."[24] We agree.

We share the goals of consumer protection and promoting competition in the marketplace. In the case of common ownership, we encourage the Commission to consider the extensive research that shows there are no anti-competitive results due to non-controlling interest in competing companies.

Moreover, proposals to limit common ownership could actually *hurt* consumers, not protect them. Thank you for the opportunity to comment on these topics. We are happy to discuss any questions or comments you may have.

Sincerely,

Tom Quaadman & Sean Heather

[24] Committee on Capital Markets Regulation, "Common Ownership and Antitrust Concerns," November 2017