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FTC Hearings Evaluate Enforcement Options for Minority Investments

Eighth FTC Hearing features debate over whether the FTC should look more closely at non-controlling investments in competing companies.

Last week, the Federal Trade Commission (FTC, or the Commission) held the eighth hearing in its series of 10 planned Hearings on Competition and Consumer Protection in the 21st Century. The FTC invited panelists to comment on corporate governance, institutional investors, and common ownership. According to the Commission, the session focused on "concerns that acquisitions and holdings of non-controlling ownership interests in competing companies, for example by institutional investors, may have anticompetitive effects." Speakers also discussed the economic literature evaluating the effects of common ownership on competition and corporate governance.

Latham & Watkins is monitoring and sharing periodic insights on the FTC hearings, with a focus on significant statements from regulators, hints about where the FTC's enforcement priorities lie, and key points of disagreement among antitrust and consumer protection influencers. For prior analyses of the FTC hearings, please visit Latham's library of Thought Leadership.

Hearing #8's Big Idea: FTC Not Ready for a "Tectonic Policy Shift"

The FTC described Hearing #8 as an opportunity to consider competition policy in light of "recent econometric studies [that] have concluded that when investors hold stock in competing firms, competition may be reduced among those commonly held competing firms." In addition to discussing, and in some cases criticizing, these studies, panelists debated whether a shift in antitrust policy to address the concerns would be premature.

While some panelists pushed for more immediate policy shifts, caution was the more common refrain.

FTC Commissioner Noah Phillips set the tone. Although he acknowledged that the emerging legal scholarship deserves close attention, he commented that "such tectonic policy shifts should not be undertaken lightly." Phillips called for further study rather than immediate action. According to Phillips, there is no clear articulation of the mechanism by which common ownership produces anticompetitive effects, or what the appropriate remedies would be. Phillips also cautioned that limitations on common ownership could discourage minority shareholders from offering input in corporate governance.

SEC Commissioner Robert J. Jackson echoed these concerns, maintaining that the common ownership literature "does not carry the heavy burden that the SEC should demand to impose limitations on public companies," and that the research is "the beginning of the conversation." Jackson emphasized that the ability of institutional investors to create diversified portfolios through small investments in a wide array of companies has "delivered an enormously important product to American families saving for retirement." Limits on minority investments could curtail retail investors' access to lower-cost, lower-risk investments. However, Jackson did call for increased transparency into institutional investor voting. He argued that virtually all corporate elections in the United States "are decided by a handful of exceptionally powerful managers," and advocated for new rules that would take advantage of existing data on institutional voting to empower retail investors with more information about "how their money is voted."

Key Remarks

- ***"Common ownership reduces managers' incentive to cut cost, increase output, maximize firm value."*** Martin Schmalz, Assistant Professor of Finance, University of Michigan Ross School of Business

Schmalz, of the University of Michigan Ross School of Business, coauthored one of the leading papers on common ownership in which the authors concluded that, when common ownership is accounted for, market concentration in the airline industry is 10 times what is "presumed likely to enhance market power" by antitrust regulators. At the hearing, Schmalz argued that the impact of common ownership on product markets is well-established. He illustrated this point by reviewing 24 studies that link common ownership to "effects on prices, quantities, product market cooperation, and innovation." While Schmalz recognized the complex economic inquiry required to prove his case, he maintained that existing research already shows the anticompetitive effects of common ownership.

Harvard Law School Professor Einer R. Elhauge concurred, arguing that empirical evidence already demonstrates a causal link between common ownership and negative effects on competition within certain industries. These remarks built on Elhauge's January 2018 paper in which he argued that "without any need for coordination or communication, horizontal shareholding will cause corporate managers to lessen competition to the extent they care about their vote share or re-election odds." At the hearing, he cited increased bank fees, higher airline prices, and barriers to entry in the pharmaceutical market as direct results of common ownership. Elhauge also outlined mechanisms by which common ownership might dilute competition, such as institutional investors voting against executive compensation packages and withholding votes in board elections.

However, several others expressed skepticism about the evidence on common ownership competitive effects. In addition to Jackson and Phillips, MIT Professor of Economics Nancy Rose said, "I don't think one can conclude the case for anticompetitive effects for common ownership has been 'proven' at this point." Rose framed the existing literature as "a good place to start but not good enough to be a place to finish."

- ***"[One useful thing the FTC could do] is to open a study, to go out and get the kind of data you would need to study this problem more closely."*** Fiona Scott Morton, Theodore Nierenberg Professor of Economics, Yale School of Management

On both sides of the debate were calls for more data to study the theory and test existing conclusions. A few speakers encouraged government agencies to study the issue further because they have better access to data. They were likely referring to the FTC's unique statutory authority under Section 6(b) of the Federal Trade Commission Act to use its subpoena power to require companies to disclose data for an industry study. The FTC could subpoena detailed data from major institutional investors, private equity sponsors, hedge funds, and others on their minority investments, board seats, and voting histories. While the FTC would keep such data confidential, a 6(b) study could open the financial industry to an in-depth inquiry.

- ***"The FTC should not and cannot ignore [executive compensation incentives], since they may be the root cause of decisions that break the law."*** Rohit Chopra, Commissioner, FTC

Building on the morning discussion of common ownership, FTC Commissioner Rohit Chopra observed in his remarks that large corporations "increasingly dominate the economy" and have "significant power to exert over the economy and democracy." He identified two trends worthy of heightened agency scrutiny: (1) rising corporate debt and (2) executive compensation. Chopra queried whether debt prevents companies from being meaningful competitors, saying, "Heavily indebted companies can get desperate, and will go to great lengths to keep creditors happy, since those lenders control their fate when companies are walking a tightrope." He added that a company saddled with debt "would have more incentive to save money by taking illegal shortcuts, or make money by beating out competitors using illegal practices." Chopra criticized the FTC's approach to a recent merger of industrial gas suppliers due to the high debt levels of the divestiture buyer. He contended that the divestiture buyer's debt obligations created substantial risks that the buyer would not be a robust competitor; however, he noted that "the Commission chose not to safeguard against these risks." Chopra argued that "the significant chance that [the risks could materialize] says to me that we need a new approach to evaluating the financial condition of a divestiture buyer."

Chopra also argued that excessive executive compensation creates incentives for executives to take unnecessary risks and even engage in illegal behavior to preserve short-run stock value. He excoriated executive compensation packages weighted heavily toward stock options as "a virus in the economy that is distorting incentives." In his comments, Chopra singled out the pharmaceutical industry and said that he fears that executives are focusing on abusing government process by blocking generic competition instead of focusing those resources on innovation.

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