

May 3, 2016

Executive Order Calls on Agencies to Address Industry Concentration: The Implications for Common Ownership Interests

On April 15, 2016, President Obama issued an Executive Order entitled “*Steps to Increase Competition and Better Inform Consumers and Workers to Support Continued Growth of the American Economy*.”¹ The Order called on federal agencies to identify potentially anticompetitive practices and to furnish to the Director of the White House National Economic Council a list of actions each agency can take, including rulemaking, to promote competition.² The same week, the White House Council of Economic Advisers released an antitrust-themed issue brief, which stated that “many industries may be becoming more concentrated” and enumerated a number of “potential areas for future consideration” for additional regulation.³ Included among those areas was “common ownership of stock by large institutional investors.”⁴

The potential antitrust implications of common stock ownership—particularly by institutional investors like index funds or private equity firms—has received increased attention recently. Within the last year, several widely read academic papers have addressed the subject. One claimed to identify a link between common ownership and increased prices paid by consumers.⁵ The other asserted that common ownership “can help explain fundamental puzzles about executive compensation, macroeconomic policy, and economic equality,” and advocated for aggressive scrutiny of the practice.⁶ On March 9, William J. Baer, former Assistant Attorney General for the Antitrust Division of the Department of Justice, confirmed

¹ Exec. Order No. 13725, 81 Fed. Reg. 76 at 23417 (2016), available at <https://www.gpo.gov/fdsys/pkg/FR-2016-04-20/pdf/2016-09346.pdf>.

² *Id.* at 23418.

³ Council of Economic Advisers, *Benefits of Competition and Indicators of Market Power* 13–14, April 2016, available at https://www.whitehouse.gov/sites/default/files/page/files/20160414_cea_competition_issue_brief.pdf.

⁴ *Id.* at 13.

⁵ José Azar, Martin C. Schmalz & Isabel Tecu, *Anti-Competitive Effects of Common Ownership* (Univ. of Mich. Ross School of Business, Working Paper No. 1235, Apr. 21, 2015).

⁶ Einer Elhauge, *Horizontal Shareholding*, 129 HARV. L. REV. 1267, 1278 (2016).

before a Congressional subcommittee—in response to a question from Senator Blumenthal—that the DOJ is “looking at” the “common ownership issue . . . in more than one industry.”⁷

As we outline below, small levels of common ownership, standing alone, should not violate federal antitrust law. Nonetheless, the current focus on common ownership by enforcers and economists serves as a useful reminder that potential antitrust concerns might arise from common ownership, as well as from the roles that private equity firms and other investors may play with respect to competing companies in which they are invested.

Potential Application of Federal Antitrust Law

Sherman Act § 1: Section 1 of the Sherman Act prohibits *agreements* among competitors that unreasonably limit competition.⁸ As agreement is the essence of a Section 1 violation, common ownership, without more, would not violate Section 1. The authors of one of the recent studies on common ownership have observed “that investors need not explicitly communicate their interests to management for the documented outcomes to materialize.”⁹ In other words, even if one were to credit that common ownership has potentially anticompetitive effects, it would not follow from there that those effects result from the sort of conduct that Section 1 condemns.

If an investor were, however, to use its ownership position to facilitate an agreement among competitors—*e.g.*, an agreement not to compete over price—such an agreement could potentially give rise to liability under Section 1. This would be a type of “hub-and-spoke” conspiracy. Under such a conspiracy, a “hub”—an entity at one level of the market structure—coordinates an agreement among “spokes,” competitors at a different level of the structure.¹⁰ Hub and spoke conspiracies are only actionable as a single, horizontal conspiracy if there are vertical agreements between the hub and the spokes and horizontal agreements between the spokes themselves.¹¹ As a result, the mere transmittal of information from the investor to the companies—absent an agreement between the companies—would likely not constitute a horizontal price-fixing agreement even under the hub-and-spoke theory. Government regulators or civil plaintiffs might argue, however, that such agreements could be inferred from the knowing exchange of information.

⁷ Oversight of the Enforcement of the Antitrust Laws: Hearing Before the Subcomm. On Antitrust, Competition Policy and Consumer Rights, 114th Cong. (March 9, 2016), *video available at* <http://www.judiciary.senate.gov/meetings/oversight-of-the-enforcement-of-the-antitrust-laws-2016>.

⁸ 15 U.S.C. § 1.

⁹ Azar, *supra* Note 5, at 4.

¹⁰ *United States v. Apple, Inc.*, 791 F.3d 290, 314 (2d Cir. 2015).

¹¹ VI Phillip E. Areeda & Herbert Hovenkamp, *Antitrust Law* ¶ 1402c (3d ed. 2010).

Clayton Act § 7: Section 7 of the Clayton Act—which is perhaps best known for its application in the merger context—bars the acquisition of stock when the effect of the acquisition or the effect of the use of the stock, *e.g.*, by voting, “may be to substantially lessen competition.”¹² This provision contains an explicit exemption for “persons purchasing stock solely for investment.”¹³ Courts interpreting this exemption have focused on whether the acquisition was part of an effort to obtain control in the company in which the investor acquired ownership.¹⁴ In evaluating intent, courts have looked at, among other things, the “historical behavior of the acquiring company” and the “commercial circumstances surrounding the transaction.”¹⁵ The precise scope of the “investment only” exemption is open to debate and it is possible that regulators and/or courts could adopt a narrow interpretation of that provision.

If the investment-only exemption applies, common ownership would be exempt from Section 7 so long as the investor continues to play such a role. If the investment-only exemption does not apply, establishing a violation of Section 7 would require evidence that the stock’s acquisition or the use of such stock substantially lessened or could substantially lessen competition. Regulators might take the view that a potential anticompetitive effect could occur in at least three different ways.

First, regulators may focus on whether partial equity interests provide investors with some degree of influence or control over competing companies. Mechanisms for such control might include board representation or the right to exercise veto power over the companies’ actions.¹⁶

¹² 15 U.S.C. § 18.

¹³ *Id.* (“This section shall not apply to persons purchasing such stock solely for investment and not using the same by voting or otherwise to bring about, or in attempting to bring about, the substantial lessening of competition.”).

¹⁴ ABA Section of Antitrust Law, *Antitrust Law Developments* 336–37 (7th ed.); *United States v. E.I. DuPont de Nemours & Co.*, 353 U.S. 586, 602–06. (1956).

¹⁵ *Antitrust Law Developments*, *supra* Note 14 at 336–37; *United States v. Tracinda Inv. Corp.*, 477 F.Supp. 1093, 1100 (C.D. Cal. 1979).

¹⁶ *Antitrust Law Developments*, *supra* Note 14, at 372–73; *e.g.*, *In the Matter of TC Group, L.L.C.*, No. 061-0197 (Jan 25, 2007) (decision and order); *United States v. Dairy Farmers of Am.*, 426 F.3d 850 (6th Cir. 2005). In *Dairy Farmers*, The DOJ challenged Dairy Farmers of America’s (“DFA”) significant partial investment in two rival dairies: Flav-O-Rich and Southern Belle. Prior to February 2002, DFA held a 50% equity stake in the company that owned and operated the Flav-O-Rich dairy. In February 2002, DFA acquired 50% voting stock in Southern Belle. After the DOJ challenged the transaction, DFA turned its common voting stock in the companies that operated both dairies into non-voting stock, and asserted that it thus lacked control over either company. *Id.* at 853–55. “The district court granted summary judgment against the government with respect to the revised agreement, because it found that DFA did not have any control over Southern Belle, let alone control over Southern Belle’s day-to-day operations, including its bidding and pricing decisions.” *Id.* at 860. The Sixth Circuit reversed. The court first found that the district court erred by disregarding the initial agreement, and held that that agreement resulted in DFA’s “controlling an undue percentage of the relevant market.” *Id.* at 862. In examining the second agreement, the court found that

Regulators may also argue that partial ownership interests could (even in the absence of influence or control) nonetheless dampen the incentives of the companies to compete. In a market without partial ownership interests, “when a firm takes away sales by undercutting its rivals’ prices, the firm’s owners gain the profits from those sales but lose no profit on the sales taken away from their rivals.”¹⁷ But when an investor has a partial equity stake in both a firm and its rival, taking away business from the rival means “taking away business from the same person who owns it.”¹⁸ Regulators have thus ordered divestitures of relatively large partial ownership interests.¹⁹ The recent studies on common ownership go further, arguing that concentration of common ownership in certain industries—where multiple investors have common ownership stakes—might create incentive shifts despite the fact that the shares held by individual investors are relatively small.²⁰

Finally regulators might evaluate whether common ownership could decrease competition by affording competitors access to each others’ non-public, competitively sensitive information.²¹

Implications of Executive and Regulatory Attention

Under the analysis above, common ownership of small amounts of stock, without more, should not violate federal antitrust law as currently enacted and applied. Indeed, former Assistant Attorney General Baer remarked during his Congressional testimony that while “as a general matter” the statutes that the antitrust agencies enforce “are flexible enough [to] accommodate the new economy,” common ownership

a showing of control is not required for a violation of Section 7, because “even without control or influence, an acquisition may still lessen competition.” *Id.* at 861. Thus, even though DFA lacked a voting interest in Southern Belle under the revised agreement, the court found that the agreement could reduce competition because DFA could, for example, “leverage its position as Southern Belle’s financier to control or influence Southern Belle’s decisions.” *Id.* at 862. DFA eventually agreed to sell the Southern Belle dairy plant to another firm.

¹⁷ Elhauge, *supra* Note 6, at 1269.

¹⁸ *Id.*

¹⁹ *E.g.*, *United States v. AT&T*, 65 Fed. Reg. 38,584 (DOJ June 21, 2000) (AT&T indirectly controlled Excite@Home. MediaOne, which AT&T sought to acquire, held approximately 25% positions in Excite@Home’s competitors Road Runner and Time Warner. AT&T was required, among other things, to divest MediaOne’s direct interest in Road Runner.).

²⁰ Azar, *supra* Note 5, at 4.

²¹ *E.g.*, *T.C. Group*, 72 Fed. Reg. 4508, 4510 (aid to public comment).

might stand as “one exception,” adding that it was “not clear” to him “that the antitrust laws existing today do fully reach it.”²²

While the level or concentration of common ownership may be new, the concerns it has animated are not. Since its enactment in 1914, for example, Section 8 of the Clayton Act has prohibited so-called “interlocking directorates,” which occur when two competing corporations share one or more directors in common.²³ It is well recognized that Congress intended Section 8 to serve a prophylactic purpose by removing the opportunity for interlocking directors or officers to enable competing corporations to coordinate their activities through either explicit collusion or the exchange of competitively sensitive information.

Given this history, the DOJ’s interest in common ownership, and President Obama’s call for “pro-competitive rulemaking and regulations,”²⁴ federal agencies may seek to enact new regulations targeting cross-ownership or to apply existing laws and regulations in novel ways.²⁵ Responding to President Obama’s Executive Order—which requests agencies to provide a list of potential actions for enhancing competition to the National Economic Council within 60 days of that Order—may provide one such opportunity. And former Assistant Attorney General Baer noted that if after its investigation, the Antitrust Division did not “think [they] have the authority to deal with the problem under the existing antitrust laws,” they would “not hesitate to come back to Congress and inform [them] of that fact.”²⁶

Institutional investors and companies should be cognizant of this increasing focus. As outlined above, investors should consider carefully the implications of actions that could be perceived as exercises of control or influence over competing companies in which they have common ownership interests. Investors should also consider precautions that would limit the sharing of competitively sensitive information or the use of that information by the investor to coordinate the actions of their companies. Above all, investors engaging in common ownership should stay attuned to the regulatory environment and ensure that their practices keep pace with developments in the law and its application.

²² Oversight of the Enforcement of the Antitrust Laws: Hearing Before the Subcomm. on Antitrust, Competition Policy and Consumer Rights, 114th Cong. (March 9, 2016), *video available at* <http://www.judiciary.senate.gov/meetings/oversight-of-the-enforcement-of-the-antitrust-laws-2016>.

²³ 15 U.S.C. § 18. For more information on Section 8—including discussion of its safe harbors—see our publication entitled “Interlocks Under Section 8 of the Clayton Act: Implications of the FTC’s Investigation of Apple and Google,” *available at* <https://www.paulweiss.com/media/102450/14Oct09FTC.pdf>.

²⁴ Exec. Order. No. 13725 at 23418.

²⁵ As just one example, the authors of one of the recent studies have suggested that antitrust agencies could adapt their current merger analysis under Section 7 of the Clayton Act to take common ownership into account. Azar, *supra* Note 5, at 37.

²⁶ Oversight of the Enforcement of the Antitrust Laws: Hearing Before the Subcomm. on Antitrust, Competition Policy and Consumer Rights, 114th Cong. (March 9, 2016), *video available at* <http://www.judiciary.senate.gov/meetings/oversight-of-the-enforcement-of-the-antitrust-laws-2016>.

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