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Overlapping Minority Ownership Positions: A Legal Perspective

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Assuming some economic effect, what are the pertinent questions?

- What is the mechanism?
- Could existing law be applied to address the posited anticompetitive effect?
- Could law be changed to address the issue without overreaching?

This is a live issue…

"I can tell you it is an issue we are looking at, that ***we are looking at in more than one industry****, and it is an area where* ***if we don't think we have the authority to deal with that problem under the existing antitrust laws, we will not hesitate to come back to the Congress*** *and inform you of that fact."*

AAG Baer at Oversight Hrng (3/9/16)

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Possible mechanisms

Broadly, three candidate mechanisms:

- There is some kind of actual agreement — Section 1 issue

OR

- Something "in between" – perhaps overlapping ownership facilitates "oligopoly" behavior in some way, through incentives, new expectations regarding behavior of others, new avenues for communications/touch points, etc.

OR

- We just have no idea, but the data suggest an effect

(Last two bracketed:) potential Section 7 issue

Mechanism 1 – outright agreement

Section 1 plainly reaches any actual agreement resulting from overlapping ownership:

> "The easy part is where we can show collusion, we've got full authority to go after it. It's been publicly reported we are looking at . . . whether or not there is ongoing capacity coordination among the big four. It's under investigation."
>
> ***Baer at Oversight Hrng***

Is it that easy? There are still many hard questions …

Mechanism 1 – outright agreement

Some hard questions – horizontal agreement among companies

- Absent direct evidence of an agreement between competing industry participants, what circumstantial or ambiguous evidence would support finding unlawful horizontal agreement?
- Many categories of potential evidence pose challenges to enforcement.
  - Consciousness of interdependence likely exists in every “oligopoly” even absent overlapping ownership, as does substantial information about plans of rivals.
  - Communications with major shareholders about plans and market conditions are expected and encouraged
- Well-counseled investors and companies will avoid troublesome forms of communication

Mechanism 1 – outright agreement

Some hard questions – a series of vertical agreements between investors and companies

- Proof of one-on-one understandings about company's plans/strategies between company management and major shareholders likely not sufficient – need a "rim"
- And may be hard even to prove individual "spokes" in such a conspiracy – where is the agreement with the shareholder?

Mechanism 1 – outright agreement

Some hard questions – a series of vertical agreements between investors and companies

- Likely even more difficult to prove the "rim" of the wheel
  - Cases like *Interstate Circuit* and *Toys-R-Us* involve consciousness of the common terms being from rivals sought by major commercial counterparties
  - *In Re: Musical Instruments & Equipment* (9th Cir 2015) suggests that motive to please a major counterparty (and by extension investor) cuts against inferring agreement from parallel action

> *"All of the manufacturer defendants were dealing with the same important customer, Guitar Center, which ostensibly exercised its considerable market power to demand similar terms from each manufacturer for its own benefit. The manufacturers' similar response to this market pressure is a hallmark of independent parallel conduct—not collusion."*
>
> *In Re: Musical Instruments & Equipment*

- Even if proven, may well be analyzed under rule-of-reason

Mechanism 1 – outright agreement

Agreements among investors?

- Section 1 risks for shareholders if they coordinate, or discuss, with shareholders of other companies how they intend to influence management of the competing companies they own

- Note that this issue is present *even absent overlaps* within an individual shareholder.

The acquisition as the mechanism

At the other end of the spectrum, Clayton 7 arguably could address any anticompetitive effects of an acquisition of shares, whatever the "mechanism."

The "simple" thesis:

- An investment by investor X in a company that competes with X's pre-existing holdings in another company is an "acquisition of securities" covered by Section 7
- The data show that such an investment, if consummated, will tend to affect competition in a line of commerce – that of the owned company

But there are some big questions here:

Traditional analysis of minority acquisitions

Three key issues:

- Control/influence:
  - Does acquisition give one party control/influence over competitive actions of its rival (or over a company that competes with another entity in its portfolio)?
- Information flow:
  - Does acquisition create conduits of information flow that facilitate coordination?
- Incentives:
  - Does the acquisition create unilateral incentives to compete less vigorously?

Does the traditional analysis work here?

Start with assumption that a shareholder with stakes in multiple rivals has incentives for markets to be less competitive …

- Control/influence
  - Perhaps institutional shareholders are inherently influential with company managers?
- Information flow
  - Perhaps large shareholders convey – overtly or implicitly – information about the expected behavior of competing firms?
- Incentives
  - Perhaps managers act to please large shareholders, and may take account of interests that reflect overlapping ownership?

> "So when United is deciding how much to compete against the three other airlines, it has to make a judgment whether it is willing to harm the shareholders of those airlines which are also its own shareholders."
>
> ***Baer at Oversight Hrng***

Does the traditional analysis work here?

Some difficult questions:

- Valid to assume that a shareholder with stakes in multiple rivals always has incentives for markets to be less competitive in the short term?
- Control/influence:
  - Are institutional investors any more influential that the admonitions sell-side analysts and other representatives of "The Street"
- Information flow:
  - Why isn't there already an expectation that rivals will recognize their interdependence and behave accordingly?
  - How does any given ownership overlap tip the scales toward tacit coordination?
- Incentives:
  - Assuming managers are the ones pulling competitive punches, why do they have an incentive to favor the interests of a small group of investors over other shareholders, especially when each's stake is rather small?
  - Or is a small linkage to the welfare of rivals enough to tip the balance, while also making all shareholders better off?

Other obstacles to a Section 7 case

- The HSR notification issue – are these positions for “investment only”
- The effects issue: how to prove that the “Azar” effect is real and applies to this industry, this transaction, etc
  - The lack of precedent will exacerbate this problem: agencies and courts have generally not found a problem where minority ownership interests are below 20% (where “incentive” concerns may kick in) absent express levers of influence/control
  - Section 7 cases tend to demand proof of a “mechanism” vs. a change in managerial (or shareholder) approach – *see U.S. v. DFA*
- The causation issue:
  - Even if there may be some cumulative anticompetitive effect, how to tag *this particular investment* with that effect.
  - How take account of previously created positons that escaped challenge at time they were created?

Other obstacles to a Section 7 case

- Add to all of this the likely view of courts that
  - Investors should be free to take (passive) positions across an entire industry – potential benefits in terms of
    - Diversification
    - Corporate governance
    - Liquidity
  - Firms in the industry should be free to benefit from those investments and communicate with those investors

Other ways of reaching the "in between"?

If the mechanism is something other than an outright agreement, it is hard to see how existing antitrust law could reach it outside the Section 7 framework.

- All of the difficulties with a Section 7 case would be magnified exponentially given the view of courts that oligopoly behavior does not violate Section 1 or Section 2
- Likewise courts have rejected efforts to apply Section 5 of the FTC Act to oligopoly conduct, absent agreement to adopt facilitating practices

What might new tools look like?

- New notification rules?
  - Alteration of passive investment exemption
  - Lower thresholds where overlap exists?
  - How address new overlaps created by company behavior (*e.g.*, entering new markets) rather than new investments?
- Revisions to Section 7?
  - E.g., to facilitate challenges to series of past transactions having cumulative effects
- More powerful oligopoly tools?
  - *E.g.*, FTC exercise of its rulemaking authority (as proposed by Jon Baker)
  - How could these tools avoid sweeping too broadly?
  - History of Section 5 in this area counsels caution
- A more "regulatory" approach to overlapping ownership?
  - Limits on overlapping investments
  - Limits on contact between investors and company managers
- Other ideas?