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Introduction to special issue on common ownership and interlocking directorates

Amelia Fletcher, Martin Peitz and Florence Thépot

Common ownership by institutional investors – of minority stakes across multiple competing firms – has become a subject of heated debate in the antitrust community. While often driven by portfolio diversification strategies, rather than anti-competitive intent, common ownership can result, in some sectors, in the concentration of financial ownership, with possible anti-competitive effects.

Over the years, competition authorities on both sides of the Atlantic have taken note. For example, in 2018, the US Federal Trade Commission held a hearing on common ownership.[1] In the same year, Margaret Vestager, at that time the Competition Commissioner at the European Commission, stated that the Commission is "looking carefully" at common ownership given indications of its increase and potential for anticompetitive effects.[2] In 2017, the Competition and Markets Authority (CMA) examined the extent of common ownership in the banking, insurance, and grocery retailing industries in the UK.[3]

Closely related, but currently less discussed, is the question of interlocking directorates among competing companies (companies sharing corporate board members). One key issue is whether these can soften competition, either on their own or in combination with financial links. While in the US, Section 8 of the Clayton Act expressly prohibits interlocking directorates between competitors, there is no such prohibition in the EU (apart from Italy in the financial sector). In spite of the prohibition in the US, the FTC recently stated that interlocks still raise competitive concerns.

In blurring the market-firm boundary, any anti-competitive effects of common ownership and interlocking directorates potentially fall outside existing competition law. For some commentators, this is a serious problem, that requires addressing with new tools. They note a number of recent empirical studies, which draw attention to potential harm from common ownership by institutional investors holding small, parallel equity positions in several competing firms within concentrated industries. Other commentators argue either that these studies are flawed, and that there are highly unlikely to be any significant effects, or that the existing toolkit is sufficient if there are anticompetitive effects.

This timely special issue provides valuable additional perspectives, with a unique combination of legal and economic evidence from leading voices from both sides of the Atlantic. It uniquely brings together articles on common ownership and interlocking directorates, as they raise similar competitive concerns, and as, José Azar demonstrates here, often go hand in hand. This special issue was launched

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[1] Federal Trade Commission, *Transcript of FTC Hearings Session #8: Common Ownership*, December 2018. https://www.ftc.gov/news-events/events-calendar/ftc-hearing-8-competition-consumer-protection-21st-century.

[2] Margrethe Vestager, *Competition in Changing Times*, FIW Symposium, Innsbruck, 16 February 2018. See also Global Competition Review 'DG Comp Looking into Common Ownership, Says Vestager', 19 February 2018.

[3] Competition and Markets Authority, *Common Ownership by Institutional Investors and Its Impact on Competition: Note by the United Kingdom*, OECD, 5-6 December 2017. https://one.oecd.org/document/DAF/COMP/WD(2017)92/en/pdf and Siobhan Dennehy, presentation slides *Common Ownership in the United Kingom*, available at https://www.oecd.org/competition/common-ownership-and-its-impact-on-competition.htm
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by the virtual JCLE Conference on Common ownership, interlocking directorates & competition: a transatlantic perspective, on 7 December 2020.[4]

Interlocking directorates

Academic discourse on interlocking directorates is not new. However, the increased attention to common ownership has also brought to light the increased tendency of interlocked directors to serve in the same industry. In earlier work, Yaron Nili termed these directors 'horizontal directors', and shone a light on the benefits they bring to investors and companies but also the risks they pose to governance and competition. The three articles on interlocking directorates in this special issue are focused on assessing the extent of this issue, how it has changed (or not) over time, and how they link with common ownership.

In *"Horizontal Directors Revisited"* Yaron Nili adds to the factual evidence base about the prevalence of horizontal directors, armed with six additional years of data from the U.S. He finds that the prevalence of horizontal directors has remained steady. The author sees this a clarion call to regulator, urging them to directly address the issue of horizontal directors.

Italy provides an interesting case study with respect to interlocking directorates. During the 20th century Italy was characterized by widespread minority shareholdings and interlocking directorates, especially in the insurance and banking sectors. However, in 2008 Italy entered a deep economic crisis. Concerned about a lack of competition in the financial sector, in 2011, Italy introduced a ban on interlocking directorates in the financial sector. The Italian anti-interlocking provision prohibits any member of the board of directors or of the internal control body, as well as any top manager of firms operating in the banking, insurance, and financial sectors to hold any of those offices in a competing company or group.

In *"Evaluating the Effectiveness of the Italian Interlocking Ban: An Empirical Analysis of the Personal Ties among the Largest Banking and Insurance Groups in Italy"* Federico Ghezzi and Chiara Picciau provide a descriptive assessment as to whether the Italian interlocking ban has been effective looking at intra-sectoral links in the banking and insurance sectors. The article maps the personal ties among the 25 largest banking groups and the 25 largest insurance groups operating in Italy over time. The authors find that at the end of 2010 interlocking directorates were widespread in both the banking and the insurance sectors and involved many of their main players. By the end of 2012 – that is, after the ban has been introduced – they could not detect any personal tie among the banking groups in their dataset, and only one prohibited interlock among the 25 largest insurance groups. At the end of 2018, they did not detect any relevant interlocking in either the banking or the insurance sector. This suggests that the Italian interlocking ban has generally been effective at severing personal links among the largest banking and insurance firms in the country. Yet, as the authors acknowledge, it is difficult to draw any clear conclusion on the procompetitive effect of the ban in the banking and insurance industries. In fact, while interlocking directorates seem to have disappeared, these sectors are still characterized by extensive minority shareholdings and have become more concentrated over time.

In *"Common shareholders and interlocking directors: The relation between two corporate networks"* José Azar studies the empirical relationship between common ownership and interlocking directorships. He estimates a gravity equation model for the probability that a pair of firms will have a

[4] The summary and recordings of the conference are available at https://www.epant.gr/en/conferences-seminars-of-2020/item/1317-common-ownership-interlocking-directorates-competition-a-transatlantic-perspective.html

common director, as a function of the geographic distance between the firms, their sizes, and a set of covariates, including measures of common ownership between the firms. The main finding is that, robustly across several measures of common ownership, firm pairs with higher levels of common ownership are associated with a higher likelihood of sharing directors. Also, their distance in the network of directors is smaller on average. Consistent with the "gravity" interpretation, larger firms are more likely to share directors, and firms that are geographically more distant are less likely to share directors.

Common ownership

While a growing body of empirical research has linked common ownership to product market outcomes, little evidence has been uncovered to explain the underlying mechanism for this effect, and in particular how common owners might use corporate governance mechanisms as a conduit to affect relevant firm decision-making. In *"Interventions by Common Owners"* Nathan Shekita contributes to filling this void by describing 30 cases of common owner intervention found in the public domain. Institutional investors—the largest form of common owners—report thousands of engagements with portfolio firms. Despite the frequency of reported engagements, a common owner's ability to work "behind the scenes" yields limited disclosure on the details of each intervention. Nathan Shekita delves into the specifics of engagements found through a comprehensive search of media coverage, regulatory proceedings, policy group analysis, and annual stewardship reports.

In *"Common Ownership Patterns in the European Banking Sector – The Impact of the Financial Crisis"* Jo Seldeslachts, Albert Banal-Estanol and Nuria Boot document the impact of the 2007–2009 financial crisis on ownership and common ownership patterns in the largest European banks. Several banks witnessed a large capital inflow from local investors, mainly governments. Since these investors typically hold equity in only one bank, this has led non-common owners to hold the majority share in the large European banks during a short period, on average, vis-à-vis the coalition of common owners (typically investment managers). While outside the scope of the article, the interaction of one large-stake non-common investor versus a coalition of smaller-stake common investors warrants further investigation, not only in the European banking sector but more in general in European markets, as the research on common ownership has mainly focused on US markets, where large-stake non-common investors are largely absent.

As indicated before, minority shareholdings have been on the regulatory agenda of competition authorities for some time. EU and U.S. antitrust agencies are closely following the debate and have indicated an appetite to act. In *"Varieties and Mechanisms of Common Ownership: A Calibration Exercise for Competition Policy"* Anna Tzanaki connects the common ownership debate to merger control and explores: the aims and scope of legal control as regards partial acquisitions in different jurisdictions; the nature of potential competition effects arising from passive minority shareholding; and the plausibility of common owners' anticompetitive strategies from a corporate governance perspective. Drawing a distinction between 'concentrated' and 'diffuse' common ownership, the article sheds light on the different supporting mechanisms and varying potential harms. In particular, 'passive influence' mechanisms characterizing 'diffuse' common ownership may not only generate plausible and material competition concerns in given circumstances, but present challenges for the effective jurisdictional and remedial design of merger law frameworks. Anna Tzanaki argues that competition policy should stay current by explicitly recognizing these insights in enforcement practice and developing guidelines on how to treat common ownership cases in the future.