Horizontal Shareholding and the EU Competition Law

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I. Defining the terms and the problem

So-called "horizontal shareholding" (HS) or "common shareholding" is the participation of common shareholders, in particular institutional investors (IIs), in the capital of competing companies.

Economic studies on the US airline industry and banking sector over the past decade showed that HS in the leading companies on highly concentrated markets may lead IIs to discourage competition between the portfolio companies (PCs) in order to raise market prices and ultimately the stock value of the PCs.

The findings of those studies have been vigorously disputed but new sectoral studies confirmed that HS may indeed result in restrictions of competition.

II. The growing importance of institutional ownership

- The percentage of all publicly listed stocks in the US held by physical persons decreased from 84% in the mid 1960s to ca. 40% in the first years of 2010s.
- Between 2011 and 2014 passive investment funds (in particular index funds and ETFs) doubled their Assets under Management (AuM).
- At the end of 2015 these funds had at least 4 trillion USD under management.
- In June 2016 the "Big Three" IIs (BlackRock, Vanguard, State Street) managed more than 90% of all AuM in passive equity funds.

III. Causal Mechanisms of the anticompetitive effects

IIs, although minority shareholders, are in a position to influence the managers and consequently the behavior of the PCs, mainly through:

1. Voting in the elections for the BoD. In order to maximize their re-election chances managers try to maximize the weighted average of their shareholders' profits from all their shareholdings by raising prices,

2. Direct communication with management of PCs which is quite common and has pricing policy as a usual topic,

3. Executive compensation. When compensation is tied to the performance of the market instead of their firms managers are incentivized to compete less vigorously.

IV. HS under US Antitrust Law

- ***Elhauge*** takes the view that HS can be tackled under sec. 7 Clayton Act (which bans stock acquisitions resulting in HS with anticompetitive effects) and under sec. 1 Sherman Act (which is applicable to contracts between HS and PCs incentivizing the latter to lessen competition).

- ***Rock/Rubinfeld*** advocate guidelines for diversified shareholders which would provide for a merger control safe harbor for investors holding <15% of a company's shares without a representative on the BoD and without engagement or beyond the normal engagement in corporate governance

- ***Posner/Scott Morton/Weyl*** submit that investors with a diversified portfolio may not hold more than a 1% share of an oligopolistic market unless it is a free-standing index fund that commits to being purely passive. Alternatively, IIs may invest in single competitors without restrictions.

V. Dealing with HS under EU Competition Law:

1. The EU Merger Regulation 139/2004 (EUMR)

According to *Prof. Elhauge* the problem can be tackled under the existing legal framework. I respectfully disagree for following reasons:

The prerequisite of the application of EUMR is the acquisition of sole or joint control. Such an acquisition of control is missing here since

- a series of acquisitions by IIs enabling a set of HS to collectively exercise decisive influence over target companies cannot qualify as joint control without stable coalitions or extensive links between minority shareholders
- a passive strategy of IIs cannot establish control over PCs
- the fact that IIs are shareholders of companies active in oligopolistic markets does not make those companies collectively dominant. Given that common shareholders are usually the only link between the PCs the requirements of the *Airtours* and *IMPALA* judgments are not satisfied.

2. Is Article 101 TFEU applicable to HS?

Article 101 TFEU is unlikely to apply to HS because:

- the shares of the PCs are acquired on the stock market. A meeting of minds and, therefore, an agreement between buyer and seller of the shares cannot be established.

- Moreover, capturing anticompetitive effects caused by HS as concerted practices is almost as difficult as capturing as concerted practice parallel behavior attributable to an oligopolistic market structure. Lack of communication cannot be replaced by the indirect link of common shareholding which influences the PCs' competitive behavior.

3. Abusive acquisition of minor shareholdings? Abusive excessive pricing?

The acquisition of HS by IIs is also unlikely to violate Art. 102 TFEU, since

- IIs usually have no dominant position and in addition their position will not be strengthened through the acquisition of a minority shareholding in a company active on a different market.

As regards pricing

- Prices charged by the PCs cannot be considered abusive just because they are the result of HS. Price increases of 5%, as recorded in the airline industry can be hardly held excessive under Art. 102 TFEU

►In any event HS is a structural problem which cannot be tackled with behavioral rules (Articles 101 & 102 TFEU), since such rules neither prevent nor eliminate the causes of anticompetitive effects.

VI. Do we need a new legal framework for HS or more reliable evidence on its anticompetitive effects?

The reaction of the EU Commission to HS:

in the merger cases *Dow/DuPont* and *Bayer/Monsanto*: *common shareholdings should be taken as a contextual element in the appreciation of any significant impediment of competition*

► Is this reaction sufficient for "the greatest anticompetitive thread of our time" (*Elhauge*)?

The prevailing view advocates more research on the causal link between HS and restrictions of competition before taking measures to tackle it

► Is it realistic to expect convergence of the different theoretical views on the interpretation of empirical evidence?

► Does the difference of views in economic and legal theory excuse the passivity of competition authorities and legislators ?

VII. Two possible ways to deal with HS

1. Widening the scope of application of the EU Merger Regulation

This approach would focus on highly concentrated markets and provide for the introduction of a duty to notify acquisitions of more than 5% in leading companies.

The EU Commission would gain insight into tight oligopolies without imposing substantial burdens to IIs and could intervene against certain acquisitions likely to lessen competition.

The assessment on a case by case basis would take into account the particularities of each HS but

such a control would quite often remain theoretical mainly due to the difficulty to establish a causal link between HS and the restriction of competition.

2. A more drastic intervention: Taking regulatory measures

Introduction of a generally applicable rule related to the composition of the products offered by the IIs in the EU.

► It could e.g. provide that no mutual fund shares could be traded in the EU if those funds invested in more than one company active on highly concentrated markets in the EU as predefined by the Commission.

Where the oligopoly consists of a group of leading companies and some smaller ones, the trading restrictions concern only the former.

● Such a rule would tackle a restriction of competition which does not constitute an infringement of EU competition law – Case of regulation in place of competition similar to the EU Roaming Regulation (RR).

Protection of competition v. freedom of investors to choose

Intervention protecting consumers against excessive prices, even if it might have negative economic consequences for certain operators, has to be proportionate to the aim pursued

■ The benefits expected from the discussed regulatory measures against HS seem to outweigh against the harm on investors since:

- the measures concern a limited number of markets
- investment risk diversification can be achieved by investing in different markets
- the anticompetitive effects of HS may not be overlooked because of their positive impact on certain undertakings and investors
- the fall in equity prices would be more than compensated for by increases in consumer surplus, and increases in total welfare.

VIII. Conclusion

► A cautious – rather than ambitious – attempt to deal with HS as a risk of variable degree for the functioning of certain highly concentrated markets is not likely to cause *false positives* and thus to harm investors, institutional entities or natural persons.

This would hold true even if the risks the adopted measures seek to tackle do not turn out to be as serious as anticipated.

Thank you for your attention!