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DOJ Investigates Cross-Ownership by Institutional Investors

On Capitol Hill last week, the Assistant Attorney General for the Antitrust Division of the Department of Justice, William J. Baer, confirmed that the DOJ is investigating potential antitrust issues arising from investors' "cross-ownership," or minority shareholdings, in firms that compete against each other in concentrated industries. Baer's statement follows two recent academic papers suggesting that institutional investors' minority interests in major U.S. airlines may reduce competition among the carriers. Baer told a Senate subcommittee that the DOJ is investigating cross-ownership "in more than one industry," and press reports indicate that the airlines industry is one of these.[1] Notably, Baer acknowledged that it was unclear whether cross-ownership alone would violate the existing antitrust laws, absent evidence of collusion.[2]

Cross-Ownership Theory

A recent working paper by economists, including a professor at the University of Michigan, examines whether cross-ownership of airlines' stocks by diversified institutional investors has led to higher air fares.[3] The study found that increased cross-ownership of the major airlines by institutional investors correlated with higher airfares for consumers.[4] Building on that work, a Harvard Law School professor recently published a law review article advocating aggressive antitrust enforcement against cross-ownership in airlines and other industries.[5]

According to these authors, businesses have less incentive to compete when they have significant minority shareholders in common with their rivals. Under the theory, because the institutional shareholder

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1 *See Oversight of the Enforcement of the Antitrust Laws: Hearing Before the Subcomm. On Antitrust, Competition Policy and Consumer Rights*, 114th Cong. (March 9, 2016) (unpublished); *see also* David McLaughlin & Mary Schlangenstein, *U.S. Looks at Airline Investors for Evidence of Fare Collusion*, Bloomberg Business (Sept. 22, 2015), *available at* http://www.bloomberg.com/news/articles/2015-09-22/do-airfares-rise-when-carriers-have-same-investors-u-s-asks.

2 *Oversight of the Enforcement of the Antitrust Laws: Hearing Before the Subcomm. On Antitrust, Competition Policy and Consumer Rights* ("[Cross-ownership] is new. It is not clear to me that the antitrust laws existing today do fully reach it.")

3 José Azar, Martin C. Schmalz & Isabel Tecu, *Anti-Competitive Effects of Common Ownership*, 14 (Ross School of Business, Working Paper No. 1235, Apr. 21, 2015).

4 *Id.* at 37.

5 Einer Elhauge, *Horizontal Shareholding*, 129 Harv. L. Rev. 1267 (2016).

benefits when all of its investments in an industry succeed, the investor would prefer that its portfolio investments avoid competing with one another to boost industry-wide profits. Portfolio firms, in turn, have knowledge of these common investments and, the authors argue, refrain from competing in order to please their largest shareholders. In addition, the authors suggest that institutional investors offering passively managed index funds often seek to influence management of public companies.[6] The cross-ownership theory is novel and raises numerous questions, including why the airlines or other issuers would favor one set of investors over shareholders as a whole and risk exposing themselves to fiduciary duty claims.

Airlines Investigation

According to press accounts, the DOJ is probing cross-ownership in connection with its ongoing investigation into whether the airlines colluded on capacity or price. Press reports indicate that the DOJ asked for information, via a civil investigative demand, related to the airlines' meetings with shareholders whose stakes exceed two percent in which capacity was discussed.[7] Reports suggest that the DOJ is investigating what role, if any, these meetings may have had in the airlines' decisions relating to capacity and pricing.

Up in the Air

Cross-ownership as a theory of antitrust harm is likely to encounter skepticism in the courts.[8] Section 1 of the Sherman Act would require evidence that a shareholder facilitated an agreement among competing firms; cross-ownership alone would not be sufficient to establish a violation. Section 7 of the Clayton Act, which prohibits stock acquisitions that may substantially lessen competition, contains an exemption for acquisitions solely for investment, meaning that a plaintiff would need to show that the institutional investor actively sought to influence management of the company to lessen competition.[9] In addition, institutional investors' individual ownership stakes in public companies are generally small in percentage terms, often five percent or less.[10] Precedents challenging acquisitions of minority interests generally involve larger percentage interests, contractual control rights, and/or board seats in a competitor.[11]

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6 *See* Azar, at 4 ("For example, it was recently shown that institutional asset managers – previously presumed to be 'passive' shareholders – in fact actively and regularly 'engage' with their portfolio companies 'behind the scenes.'") (citations omitted); Elhauge, at 1306–07 ("A passive investment strategy differs from *passive ownership* because institutional investors with a passive investment strategy usually do actively seek to influence corporate management, including by direct communication, having investor executives serve on corporate boards, and voting their shares to favor positions and management that best advance their investor interests.") (emphasis in original) (citations omitted).

7 McLaughlin, *supra* note 1.

8 *See, e.g.*, *Vantico Holdings S.A. v. Apollo Mgmt., L.P.*, 247 F. Supp. 2d 437 (S.D.N.Y. 2003) (rejecting motion to preliminarily enjoin a private equity investment firm's acquisition of debt and contractual control rights in a competitor of a portfolio company).

9 15 U.S.C. § 18 ("This section shall not apply to persons purchasing 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.")

10 *See* Azar, at Table 1; *see also* Azar, Online Appendix, at Table A.1 (listing institutional shareholders' ownership interests in Delta, United, Southwest, and JetBlue ranging from 1.6% to 14%).

11 *See, e.g.*, *United States v. Dairy Farmers of America*, 426 F.3d 850 (6th Cir. 2005) (challenging an acquisition of 50 percent interest in a competitor of a 50 percent held firm); Complaint at ¶22, *United States v. AT&T Inc. and*

Takeaways

Going forward, investment firms should be aware of emerging antitrust scrutiny of cross-ownership and consider reviewing their portfolios to identify cross-ownership investments in concentrated industries. Investors should be particularly sensitive to antitrust considerations regarding such ownership, including potential filing obligations under the Hart-Scott-Rodino Act, if they intend to seek to influence management decisions of an issuer. Most importantly, investors should be mindful of any actions that could be construed as facilitating coordination between competing companies in which they hold minority positions.

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Dobson Commc'ns Corp., No. 1:07-CV-01952 (D.D.C. Oct. 30, 2007), *available at https://www.justice.gov/atr/case-document/complaint-34* (challenging acquisition of a 10 percent stake in a competitor, which included rights to control "core business decisions" of the firm); Complaint at ¶¶34–35, *In the Matter of TC Group, L.L.C. et al.*, Dkt. No. C-4183 (F.T.C. Jan. 25, 2007) (challenging private equity firms' acquisition of 22.6 percent interest and board seat in competitor of existing portfolio company).

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