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Index Funds, Strategic Engagement and Common Ownership Theory (A Rising Tension Between Competition and Governance in the EU)*

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ABSTRACT: Common ownership theory alerts that the existence of horizontal minority holdings in various companies of an oligopolistic market could have anti-competitive effects. Institutional investors, particularly index funds, fit in this investment pattern. They may try to soften competition to maximise their overall portfolio through governance mechanisms. In a time when engagement of institutional investors might increase due to the transposition of the Shareholders Rights Directive II (SRD II), it might also have a counter effect: the decrease of consumer welfare when the price of product rises, or product innovation is undercut due to anticompetitive practices between companies which share the same shareholders.
The aim of this paper is to contribute to the common ownership theory, examining whether engagement, the most used governance mechanism by index funds, might be one of the causal links that bring along anticompetitive effects. In this vein, the paper considers the difficulties of ex-post competition enforcement to tame the adverse effects of common ownership. Even though SRD II transparency rules might help to detect these strategies, the need to reopen to debate the need to reform the scope of EU merger control regime is also considered, namely, to include the supervision of non-controlling acquisitions to prevent common ownership cases. In other words, this paper tries to strike a balance between the positive role of index funds as monitors of good corporate governance and the anticompetitive effects that might rise due to their long-term investments in listed companies included in the same index.

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I. Introduction

The reconcentration of securities investment in the hands of institutional investors has steadily increased for years.[1]

The prominence of passive asset managers has been labelled as "new finance capitalism".[2] Not only has their presence motivated greater intermediation and, therefore, control is more detached from the beneficial owners, but their presence in the majority of corporations brings the idea that they would act as "universal owners"[3] as well. This means that instead of maximizing the value of an individual firm, they should focus on the overall value of their portfolio, which is closely correlated with the performance of the economy as a whole.[4] This idea echoes the aim of Directive (EU) 2017/828 as regards the encouragement of long-term shareholder engagement (SRD II), which intends the promotion of wider interests such as environmental, social and governance polices (ESG) by institutional investors.[5]

The problem is when institutional investors' maximization of their portfolios comes with a threat to competition. In particular, index funds invest in companies integrated in the same index. Their presence and involvement in those companies, which could be part of the same industry, might raise competition concerns. This phenomenon, which has been coined *common ownership*, will bring more returns for the beneficiaries of funds, but it could also generate economic inequality, affecting the welfare of

[1] Nowadays, index funds are the largest shareholders in 88% of the S&P 500 firms, see Jan Fichtner, Eelke M. Heemskerk, and Javier Garcia-Bernardo, "Hidden power of the Big Three? Passive index funds, re-concentration of corporate ownership, and new financial risk", *Business and Politics* 19 (2017): 313.

[2] Gerald F. Davis, 2008. "A new finance capitalism? Mutual funds and ownership re-concentration in the United States". *European Management Review* 5, no. 1 (2008): 13.

[3] Terry McNulty and Donald Nordberg, "Ownership, activism and engagement: Institutional investors as active owners", *Corporate Governance: An International Review* 24, no. 3 (May 2016): 301.

[4] James Hawley, and Andrew Williams, "The emergence of universal owners", *Challenge* 43, no. 4 (2000), 43-61.

[5] Hanne S. Birkmose, "From shareholder rights to shareholder duties – a transformation of EU corporate governance in a sustainable direction?", *Journal for International and European Law, Economics and Market Integrations* 5, no. 2 (2018): 85.

consumers.[6] In fact, it may raise prices of products that cater to lower-income household or undercut product innovation.[7] As a result, the investment pattern of common owners might clash with the intended welfare function that those institutional investors could exert.[8]

A solution to eradicate the side effects of common ownership is not easy.[9] On the one hand, the legal policy tendency is to encourage investors to engage in companies, but it might increase the sustainability of coordination between the companies in which they invest. On the other hand, the limitation of their investment pattern is controversial, as it attacks their portfolio diversification structure and the role that they play in market corporate financing could be compromised.[10]

The aim of this paper is to contribute to analyse the root of the problem, namely to understand whether it is the behaviour of institutional investors in commonly-owned firms that leads to anticompetitive effects. For that purpose, firstly, it is discussed whether active engagement of index funds through voice is the causal link that raises coordinated effects or their mere presence is enough in concentrated industries as a guarantee for companies to engage in anticompetitive conducts.[11] Secondly, the paper reconsiders the efficiency of antitrust rules in the EU to tame the adverse effects of common ownership.[12] Finally, it addresses the necessary reforms to gain a better balance between the desirable stewardship role index funds have in companies and the anticompetitive effects when common ownership patterns are exposed. In the end, common ownership is caused by the separation of ownership and control[13]; therefore, it is necessary to consider that the fidu-

[6] Frank Partnoy, "Are index funds evils?", *The Atlantic*, 2017, available at https://www.theatlantic.com/magazine/archive/2017/09/are-index-funds-evil/534183/.

[7] Hadiye Aslan, "Common ownership, creative destruction, and inequality: Evidence from U.S", *Consumers* (September 12, 2019).

[8] José Azar, Martin C Schmalz, and Isabel Tecu, "Anticompetitive effects of common ownership", *Journal of Finance* 73, no. 4 (May 10, 2018): 24.

[9] As pointed out by José Azar, "The common ownership trilemma", *University of Chicago Law Review* 87, no. 2 (2020): 293.

[10] Monopolkommission, "Common ownership", in *XXII Biennial Report of the Monopolies Commission*, (2018): 32.

[11] Nathan Shekita, "Interventions by common owners" (July 22, 2020), available at SSRN: https://ssrn.com/abstract=3658726, provides 30 cases of common ownership intervention, including engagement.

[12] Monopolkommission, "Common ownership": 34.

[13] Other examples can be consulted in Lucian Bebchuk, Reinier Kraakman and George Triantis, "Stock pyramids, cross-ownership, and dual class equity: The mechanisms and agency costs

ciary duty of institutional investors should have an ample scope, not only to protect the interests of beneficiaries as investors of a fund's portfolio, but also those of customers, employees, homeowners, etc.[14]

II. Passive investing strategy: common ownership and coordinated effects

1. The consolidation of index fund investment

Asset management is divided into two categories: actively managed (mutual funds) and passively managed (index funds and ETF). This paper focuses on the second category, precisely in index funds, due to their investment pattern.[15] This industry is currently dominated worldwide manly by three American asset managers companies: *Black Rock*, *Vanguard*, and *State Street*. Their popularity grew after the 2008 crisis, when investors realised that active funds did not protect them during market turmoil. An important shift to passive funds investment began, where more investors considered the virtues of these funds due to the opportunity of investing in all companies of a securities market but at a lower cost than doing it directly.[16]

Index fund management pursues to mimic the performance of a stock index by acquiring minority holdings of the companies integrated in it.[17] Their holdings are of a permanent nature unless the company exits the index. In this vein, the distinguishing features of their investment are diversification, long-term horizon, and low cost fees.[18] In the US, passive investing holds 20-30% of public companies[19], whereas in Europe, the

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of separating control from cash-flow rights", in *NBER Chapters* (National Bureau of Economic Research, Inc, 2000).

[14] Lynn Stout, *The shareholder value myth* (Berrett-Koehler Publishers, 2012): 90.

[15] See, Richard Deeg, and Iain Hardie, "What is patient capital, and who supplies it?", *Socio-Economic Review* 14, no. 4 (2016): 627-645.

[16] Dawn Lym, "Index funds are the new kings of Wall Street", *The Wall Street Journal*, 18th September 2018, https://www.wsj.com/articles/index-funds-are-the-new-kings-of-wall-street-11568799004.

[17] Index funds do not make the false promise of beating a defined benchmark, but they try to mimic the returns of a determined index. The results show that 64% of active funds were outperformed in US in the 1st year by benchmarks, against 49% in Europe – see SPIVA, Standard and Poors Reports.

[18] Given their investment features, they do not spend on "information-based investment decisions", in contrast, active funds tend to apply aggressive practices, see Jill E. Fisch, Assaf Hamdani, Steven Davidoff Solomon, "The new titans of Wall Street: A theoretical framework for passive investors", *European Corporate Governance Institute (ECGI) - Law Working Paper* no. 414 (2018): 21.

[19] John C. Coates, "The future of corporate governance Part I: The problem of Twelve", *Harvard Public Law Working Paper* no. 19-07 (September 20, 2018): 11.

numbers are growing: for example, 40% of the largest 30 German listed corporations have an index fund as a shareholder; in Spain, Blackrock is a shareholder in mora than 15 companies integrated in the Ibex 35[20], and 49 of 443 Australian have common ownership patterns.[21]

The presence of index funds in listed companies brings the reconcentration of power to the hands of index funds. The number of shares they own gives them a minority shareholding position of around 5-6% of the company, but if the three index funds managers have shares of the same company, their overall shareholder power goes up to 17%. They can even have more power in the general meeting due to shareholder absenteeism.[22]

Even if it is claimed that they do not pursue returns to outperform the index, it could be possible that their investment strategy enhances value.[23] Indeed, the reconcentration of power in their hands could be optimal to improve performance[24] via governance mechanisms such as engagement[25]. In this scenario, when index funds are shareholders of firms of a given industry that has an oligopolist nature, the use of governance mechanisms to improve overall firm performance comes with anticompetitive effects, and that is when the problem of common ownership takes place.[26]

In the end, the image of passive investing and managers' entrenchment is no longer valid when index funds could represent the swinging vote in important elections due to their joint power and the possibility that activists could partner with them.[27]

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[20] Fichtner, Heemskerk and Garcia-Bernardo, "Hidden power of the Big Three?": 505.

[21] Andrew Leigh, and Adam Triggs, "Common ownership of competing firms: Evidence from Australia", *IZA Discussion Paper* no. 14287 (2021): 4.

[22] Coates, "The future of corporate governance": 14.

[23] Steven Schoenfeld, *Active index investing: Maximizing portfolio performance and minimizing risk through global index strategies* (John Wiley & Sons Inc, 2004), 368.

[24] Managers' compensation depends on the assets they manage. More assets are included if profits of the portfolio increase This could be possible due to anticompetitive behaviour, Eric A. Posner, "Policy implications of the common ownership debate", *The Antitrust Bulletin* 66, no. 1 (2021): 141.

[25] For a study of the most applied mechanisms see, Ian Appel, Todd Gormley and Donald K, "Passive investors, not passive owners", *Journal of Financial Economics (JFE)* 121, no. 1 (July 2016).

[26] See Lewellen, Jonathan, and Katarina Lewellen, "Institutional investors and corporate governance: The incentive to be engaged", *Tuck School of Business Working Paper* (2018): 33.

[27] Azar, "The common ownership": 293-294.

2. Corporate governance as the missing link in the common ownership theory

Before analysing from a competition law perspective whether ex ante tools as the merger regime or enforcement could potentially prevent the behaviour of common ownership patterns, it is necessary to draw the connection with the effects in competition of the presence of horizontal shareholders. The unilateral effects are not covered in this paper, as several studies have pointed out that coordinated effects are more likely to arise than unilateral effects when indirect links such common ownership cases are examined, because the former are only possible if reducing competition is in the best interest of the company.[28]

Common owners might facilitate coordinated behaviour between competitors.[29] On the one hand, as they acquire holdings in rival firms, transparency increases because the common owner could proactively facilitate communication between firms. As a result, horizontal shareholders might act as facilitators of collusive behaviour.[30] Furthermore, they can contribute to monitor any deviation from coordinated behaviour.[31]

On the other hand, in a more subtle way, the passive presence of common owners can be seen as a guarantee of effective coordination (a signal or connecting factor[32]). They align the interest of the companies of the same market, since as common ownership increases, it reinforces firms to engage in tacit collusion.[33]

From an economic perspective, there are several studies that have empirically examined the relation of common ownership and anticompetitive effects. For example, in the US domestic airlines, changes in common ownership concentration derived in changes in prices in a given airline

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[28] Monopolkommission, "Common ownership": 23.

[29] Frazzani, Noti, Schinkel, Seldeslachts, Banal Estañol, Boot, Angelici, *Barriers to competition through joint ownership by institutional investors*, Study for the Committee on Economic and Monetary Affairs, Policy Department for Economic, Scientific and Quality of Life Policies, European Parliament, Luxembourg, (2020): 83-84.

[30] OCDE, *Common ownership by institutional investors and its impact on competition-background, Note by the Secretariat*, DAF/COMP(2017)10: 21.

[31] Kang, J.K., Luo, J., & Na, H. S, "Are institutional investors with multiple blockholdings effective monitors?", *Journal of Financial Economics* 128, no. 3 (2018): 559.

[32] See, in general, Bellamy and Child, *European Union*, 782; regarding common ownership, see Monopolkommission, "Common ownership": 23, 24.

[33] See, Andrea Pawliczek, Ashley Skinner and Sarah L. C. Zechman, "Facilitating tacit collusion: A new perspective on common ownership and voluntary disclosure", (May 3, 2019). https://ssrn.com/abstract=3382324: 9.

route, becoming 3-7% higher than if there were no common ownership and output were lower.[34] And in the US banking sector, it was found that variation of banks competition was connected to the changes in common ownership: fees, threshold, and interest rates react to modifications on competition.[35] Evidence has been found in other sectors such as the pharmaceutical industry where product-market interactions were influenced by the presence of common owners.[36] One of the last analyses conducted by the EU to determine the impact of the merger between BlackRock and BGI concluded a "positive association between common shareholding and the market power of firms".[37]

Even though these studies measured the adverse effects of horizontal shareholders, there are still some limitations to determine the relation between common ownership and coordination. Firstly, they can help make collusion more sustainable, but the problem is to prove that influential role.[38] Secondly, it is necessary to underline that it do not arise in every case. Indeed, there are some factors that determine the ability of common owners to reinforce coordination: Market conditions are relevant, and an oligopolistic market structure is an ideal setting, as cheating is more difficult, and enforcement is easier. Other factors that ease coordination are the homogeneity of the product and the disperse shareholding structure of the companies where common owners invest.[39] Furthermore, common owners become more powerful if they act in the same manner.[40]

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[34] Azar, Schmalz and Tecu, "Anticompetitive effects of common ownership": 1559.

[35] Azar, José, Sahil Raina, Martin C. Schmalz, "Ultimate ownership and bank competition", (May 4, 2019), https://ssrn.com/abstract=2710252: 34.

[36] Jin Xie and Joseph Gerakos, "The anticompetitive effects of common ownership: The case of paragraph IV Generic Entry", *AEA Papers and Proceedings* 110 (2020): 572 concluded that generic manufactures agreed to delay their entry into the market under a settlement agreement when common owners were shareholders of the brand-name drug manufacturer and the generic manufacturer.

[37] Rosati, N., Bomprezzi, P., Ferraresi, M., Frigo, A. and Nardo, M., *Common shareholding in Europe*, EUR 30312 EN, Publications Office of the European Union, (Luxembourg, 2020): 215.

[38] In the report, Frazzani, Noti, Schinkel, Seldeslachts, Banal Estañol, Boot and Angelici, *Barriers to competition*: 314 followed the De la Mano test: a merger gives rise to coordinated effects if the following conditions are met: "a) the collusion post-merger must be possible and sustainable; (b) the merger makes collusion easier, more stable, and more effective, and (c) firms reach an understanding on the collusive mechanisms. These three conditions must be met regardless of whether explicit or tacit collusion is at stake".

[39] Backus, Matthew, Christopher T. Conlon, and Michael Sinkinson, "Common ownership in America: 1980-2017", *NBER Working Paper* no. 25454 (2019): 35.

[40] Martin C. Schmalz, "Common-ownership concentration and corporate conduct", *Annual Review of Financial Economics* 10, December 2018, CESifo Working Paper Series no. 6908 (2018): 11.

In addition, regarding the incentives of common owners, it has been argued by the European Commission that common ownership, as an indirect structural link between competitors, shares the same incentive effects (to prevent undercutting) as direct links between competitors, so the same theories of harm apply.[41] However, direct links are more aggressive and secure in terms of coordination than common ownership, because the latter are third party investments.[42] Hence, common owners might not have direct control of the price setting in companies in which they have invested.[43] Consequently, there is also the problem of measuring the effects if they do not share the same theories of harm. In fact, it has not been agreed yet which is the adequate metric to apply when coordinated effects occur. For example, it has been argued that a modified version of the Herfindahl Index (MHHI), which is applied to measure market concentration, is not applicable to coordinated effects.[44]

Finally, the cause that leads to coordinated effects in common ownership cases is still not clear.[45] What features of common owners makes them more influential that other investors? This paper analyses whether stewardship could be the missing link in common ownership theory . Therefore, it is necessary to examine the value of engagement as the primary cause that leads to anticompetitive effects of common ownership such as higher collusive prices.

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[41] CASE M.7932 – Dow/DuPont Recital 45, Anex Du pont Case: 13.

[42] OCDE, U.S. submission on Antitrust issues involving minority shareholding and interlocking directorates (DAF/COMP/WP3/WD (2008).

[43] Ulrich Schwalbe, "Common ownership and competition – The current state of the debate", *Journal of European Competition Law & Practice* 9, no. 9, November 2018: 597-598.

[44] Partial ownership and unilateral effects were measured through the modified version of HHI by Daniel P. O'Brien and Steven C. Salop. "Competitive effects of partial ownership: Financial interest and corporate control". *Antitrust Law Journal* 67, no. 3 (2000): 559-614. See an analysis of the MHHI application and previous studies which were applied in Scott, C. Hemphil, and Marcel Kahan, "The strategies of anticompetitive common ownership", *European Corporate Governance Institute (ECGI) – Law Working Paper* no. 423/2018: 149. Furthermore, in a recent paper, it has been criticised that the empirical studies used "inappropriate instruments and inappropriate control samples", they suggested not to focus on mergers that took place in years 2008 and 2009 due to the financial crisis. As a result, no common ownership was found: Katharina Lewellen and Michelle B Lowry, "Does common ownership really increase firm coordination?", *European Corporate Governance Institute – Finance Working Paper* no. 741/2021, 35.

[45] Frazzani, Noti, Schinkel, Seldeslachts, Banal Estañol, Boot and Angelici, *Barriers to competition*: 90.

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III. When institutional investors are not passive owners in a horizontal shareholding scenario

1. Engagement of index funds as a governance mechanism

Index funds as shareholders have different ways to get involved with their portfolio companies. The prominent form applied by passive institutional investors is engagement through voice behind doors[46]. It is a non-confrontational involvement that aligns the interest of managers and shareholders. More aggressive governance strategies such as shareholder proposals, proxy contests, and nominating directors are exercised when voice has not been adequate to convince directors of portfolio companies.[47]

There are various forms of discussions, but those relevant are strategic engagements where a company's long-term strategy is discussed.[48] In these meetings, institutional investors could try to influence managers or directors through the explanation of what their policies are, their views on topics related to the company, and their opinion of management execution. In a context of common ownership, these directors-shareholders dialogues might be exercised actively to convince directors to lessen aggressive competition because it harms the total portfolio value of the common owner.[49] The strategy can also be used indirectly: common owners can avoid encouraging competitive actions in the companies that they invest.[50] Furthermore, these private dialogues also help directors to predict how the funds will react to voting company decisions.[51] In other words, both parts

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[46] 63% of the respondents to the study conducted by Joseph A. McCahery, Zacharias Sautner and Laura T. Starks, "Behind the scenes: The corporate governance preferences of institutional investors", *Journal of Finance* 71, (2016): 2906, said that they use the voice channel, and 45% conducted discussions with the members of the board. Edward B. Rock and Daniel L. Rubinfeld, "Common ownership and coordinated effects", *NYU Law and Economics Research Paper* no. 18-40 (2018): 13, also underline the importance of communications between common owners and managers to ascertain anticompetitive effects.

[47] There are also passive strategies, as selective omission, which remain inactive until the time when applying and active strategy increases firm value, see C Scott Hemphil and Kahan, "The strategies of anticompetitive common ownership", *European Corporate Governance Institute (ECGI) – Law Working Paper* no. 423/2018: 7.

[48] In Gleen Boraemen, *What we do. How we do it. Why it matters. Vanguard Investment Stewardship Commentary*, 2019, those vanguard strategic engagements that are characterised for high-level discussions about a company's long-term strategy and industry dynamics are underlined.

[49] Azar, Schmalz and Tecu, "Anticompetitive effects of common ownership": 1554.

[50] Ibid, 1552. It is also stated that the alarmism against index funds behaviour would make them more passive, see Bebchuk and Hirst, "Index funds": 2133.

[51] Coates, "The future of corporate governance": 16.

of the engagement are taking this tool to advance their arguments, which could be the breeding ground for anticompetitive practices.

It could be argued that index funds strategic engagement cannot pose a risk to competition because their minority holdings are not significant to advance their interests. Also, their voice does not come with the threat of exit, as they only sell their shares if the company leaves the index.[52] However, there are some relevant factors that may contribute to the suitability of engagement applied by index funds. Firstly, index funds are long-term investors. Unlike activist funds, passive investors prefer to build a long-term pacific relationship that can also be beneficial for directors.[53] The fact that they have holdings in competitors might also make their interests more convincible. Furthermore, they become more powerful when several common owners invest in the same company: even if they do not coordinate their conduct directly, it could be done indirectly when they follow the recommendations of the same proxy advisor.[54] Moreover, they can potentially outweigh the power of an activist in the firm that would push for more competition.[55] In this case, the firm, instead of maximising the interest of shareholders as a whole, could tend to advance the interests of index funds.[56] Not only could their conduct be a threat to competition, but it also creates a conflict between diversified and retail investors.[57]

Even assuming the suitability of engagement as the means to advance common owners preferences, the drawback is that there are scarcely any references to conclude that engagement is the causal link that leads firms to compete less aggressively because it occurs behind doors.[58] It is not clear whether market strategy to pursue long-term growth of the industry is

[52] Fichtner, Heemskerk and Garcia-Bernardo, "Hidden power of the Big Three?": 307.

[53] Bebchuk and Hirst, "Index funds": 2047, John D. Morley, "Too big to be activist", *Yale Law & Economics Research Paper* no. 596: 1441.

[54] Frazzani, Simona, Kletia Noti, Maarten Pieter Schinkel, Jo Seldeslachts, Albert Banal Estañol, Nuria Boot, Carlo Angelici, *Barriers to competition through joint ownership by institutional investors*, Study for the Committee on Economic and Monetary Affairs, Policy Department for Economic, Scientific and Quality of Life Policies, European Parliament, Luxembourg, (2020): 26.

[55] Regarding the pivotal role of index funds, see Fisch, Hamdani, Davidoff Solomon, "The new titans of Wall Street": 39.

[56] However, Gordon, Jeffrey N., "Systematic stewardship", *European Corporate Governance Institute – Law Working Paper* no. 566/2021: 46, noted the possibility for common ownership to take their wider interest in an industry to focus on systemic risk stewardship, to convince companies to diminish those activities that generate systemic risk through governance.

[57] Coates, "The future of corporate governance": 28.

[58] See Shekita, "Interventions": 3, for examples on the use of voice.

discussed.[59] Their engagement polices do not give enough details to ascertain if there is an anticompetitive objective,[60] although this could be found indirectly when higher prices are set up or remuneration is linked to the industry.[61] It could also be a sign of their anticompetitive interests when they vote against the likes of a hedge fund as a way of rejecting pro-competitive measures that activist pursue.[62] The lack of transparency of their engagement could have come to an end in Europe with the transposition of SRD II, but also it could result in an increase of engagement with anticompetitive effects.

2. SRD II and competition: The uncertain balance in horizontal holdings

The virtues of engagement as a channel used by index funds to advance their interest might be not used quite often due to free riding.[63] It is also added that their engagement teams do not have enough personnel to execute engagement.[64] Thus, their engagement might be conceived as selective, as common owners might prioritise companies in which their active involvement leads to major profits. For example, in a common ownership scenario, their engagement might be focused on those industries or

[59] Azar, Schmalz and Tecu, "Anticompetitive effects of common ownership": 1555.

[60] On their webpage, institutional investors underline why they engage with companies:
Vanguard: "We engage company executives and directors in open dialogue to promote governance principles that support long-term value for our shareholders (…) We characterize our approach as 'quiet diplomacy focused on results' – providing constructive input that will, in our view, better position companies to deliver sustainable value over the long term for all investors".
State Street: "We engage with companies to provide insight on the principles and practices that drive our voting decisions. We also conduct proactive engagement to address significant shareholder concerns and environmental, social, and governance ('ESG') issues in a manner consistent with maximizing shareholder value".
Blackrock: "We emphasize direct dialogue with companies on governance issues that have a material impact on sustainable long-term financial performance".

[61] Regarding the alignment of institutional investors and managers through performance tied to competing firms, see Miguel Antón, Florian Ederer, Mireia Giné, Martin Schmalz, "Common ownership, competition, and top management incentives", *CESifo Working Paper Series* no. 6178, 2018; but it has been noted that the empirical results still do not offer firm conclusions, Hemphil and Kahan, "The strategies": 1413.

[62] Azar, Schmalz and Tecu, "Anticompetitive effects of common ownership": 1558.

[63] It has been alerted to the problem of free-riding and engagement of those who remain passive investors and also benefit from those who engage, Brian R. Cheffins, "The stewardship code's Achilles' heel", *The Modern Law Review* 73, no. 6 (2010): 1015.

[64] For example, Black Rock engagement team is formed by 40 people, Bebchuk and Hirst, "Index funds": 2086.

markets in which it is more effective (i.e., oligopoly markets). Shareholder concentration is also relevant: the more dispersed shareholders are, the more power common owners may obtain.[65] In addition, the threat to use other governance mechanisms makes the possibility of softening competition credible to directors.[66]

Notwithstanding the reluctance of the practice of engagement by institutional investors, the reality is that the numbers of engagements are steadily growing over the years. In particular, the last data available of their engagements is that, in 2020, 61% of the companies were engaged by Black Rock[67], 793 were approached by Vanguard (54% of their global equity assets under management)[68], and State Street engaged with 1,750.[69]

Furthermore, it is likely that engagement ratios in Europe might increase even more due to the transposition of SRD II[70], as institutional investors and asset managers need to comply with their engagement policy or explain the reasons not to comply (Art. 3 g). The policy needs to describe how they conduct dialogues with investee companies. Annually, they have to disclose the implementation of the policy together with a general description of the voting behaviour.[71]

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[65] Azar, "The common ownership": 278, Fichtner, Heemskerk and Garcia-Bernardo, "Hidden power of the Big Three?": 509.

[66] Bebchuk and Hirst, "Index funds": 2088, alert that the usefulness of private meetings goes in hand with the possible threat for directors that they will apply other tools, such as nomination of directors or submission of shareholder proposals.

[67] BlackRock Investment Stewardship Annual Report 2020.

[68] Vanguard Investment Stewardship Annual Report 2020.

[69] State Street Investment Stewardship Annual Report 2020.

[70] In the same vein, Giovanni Strampelli, "Knocking at the boardroom door: A transatlantic overview of director-institutional investor engagement in law and practice", *Virginia Law & Business Review* 12, Issue 2 (2018): 205, admits that engagement is progressively growing due to regulation. However, it has been alerted that disclosure of engagement may vary the number of engagements and their type, see Deirdre Ahern, "The mythical value of voice and stewardship in the EU Directive on Long-term Shareholder Engagement: Rights do not an engaged shareholder make", *Cambridge Yearbook of European Legal Studie*s 20 (2018): 106-107. Furthermore, it has been pointed out that SRD II might not be enough to obtain engagement of institutional investors as they lack the incentives to do it as well as the threat to infringe concerted action regime, Antonio Roncero Sánchez, "La implicación de los inversores institucionales y de los gestores de activos en las sociedades cotizadas como opción de política jurídica", in *Cuestiones actuales de derecho mercantil* (Marcial Pons, 2018): 40-49.

[71] For a comprehensive analysis of the article, see Hanne S. Birkmose, "Article 3G: Engagement policy", in Hanne S. Birkmose and Konstantinos Sergakis, *The Shareholder Rights Directive II: A commentary* (Edward Elgar, 2021), 143-163.

Even if SRD II promotes engagement that might lead to more common ownership cases, it is arguable that the Market Abuse Regulation (MAR) could discourage some common ownership conducts. In effect, the insider trading regime prohibits any trading of material non-public information (Art. 8 MAR). This could be seen as a deterrence to engagement, as institutional investors might be fined for the mere fact of receiving the information, even if they have not asked to.[72] However, engagement seems a lawful practice, as recital 19 MAR clarifies that it does not prohibit discussions between shareholders and management about business and market development.[73]

Even though SRD II shall turn engagement policies more public, it might not be detailed enough, because the contents of the meetings remain private. There is not sufficient information to depict to which extent engagement of common owners is related to less competition of a given industry. There is not enough evidence available about the reasons behind the decision to engage, how they exert influence, and to which extent competition is on their agenda. As it is analysed afterwards, more detailed information about the content of their engagements can be valuable to detect the relation between engagement and anticompetitive effects.

IV. The constraints of EU antitrust rules on taming institutional investor behaviour

1. EU partial-mergers control for minority holdings

1.1. Minority holdings and control

First of all, it is necessary to ascertain to which extent minority shareholding acquisitions by common owners confer them control of undertakings on a lasting basis that constitute concentrations in order to fall under the review of the EU Merger regulation (EUMR)[74].

[72] However, if the information, financial data, and forecasts have been published, it is not clear whether it needs to be disclosed under Article 17 MAR, see Chiara Mosca, "Director-shareholder dialogues behind the scenes: Searching for a balance between freedom of expression and market fairness", *European Company and Financial Law Review* 15, no. 4 (December 2, 2018): 839-840.

[73] See, Strampelli, "Knocking at the boardroom door": 212; Mosca, "Director-shareholder dialogues behind the scenes: Searching for a balance between freedom of expression and market fairness", *European Company and Financial Law Review* 15, no. 4 (December 2, 2018): 850.

[74] *Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings (the EC Merger Regulation).*

A concentration arises when a change of control on a lasting basis not only results from a merger but can derive from the purchase of securities as well, as the person, or the undertaking, acquires direct or indirect control of the whole or parts of one or more undertakings (art. 3. 1, b) EUMR). In other words, the common owner shall obtain decisive influence in the undertaking, which means "the power to block actions which determine the strategic commercial behaviour of an undertaking".[75]

In order to examine whether common ownership proposed acquisitions are subject to review by the European Commission, it must be distinguished whether control is either held by one index fund or whether it is a joint control held by various index funds.[76]

Generally, sole control is obtained where an undertaking alone is able to determine the strategic commercial decisions of another undertaking because it has obtained the majority of voting rights.[77] It is uncertain that index funds acquisitions would be examined due to the nature of their holdings: they are minority holdings (around 5%), and that position does not confer them the right to appoint a director which would have led to determine strategic decisions. For the same reason, it is difficult that they would have veto power of strategic decisions that should have given them negative sole control. However, a *de facto* sole control situation would be more likely if certain circumstances are met. A minority shareholder might acquire *de facto* control in companies with disperse shareholders when it is able to obtain a stable majority of the votes at the shareholders' meeting or even to block a decision[78]. But it is dubious that the sole presence of an institutional investor will pass the Commission assessment of a stable majority.[79] The problem is that EUMR is not prepared to certain com-

[75] *Commission Consolidated Jurisdictional Notice under Council Regulation (EC) No. 139/2004 on the control of concentrations between undertakings.* OJ C 95, 16.4.2008

[76] It has been argued that the role of minority holdings in competitors could be a device to coordinate competitors' behaviour, raising coordinated effects if the merger makes tacit collusion possible, see Ioannis Kokkoris and Howard Shelanski, *EU merger control. A legal and economic analysis*: 130, Frazzani, Noti, Schinkel, Seldeslachts, Banal Estañol, Boot and Angelici, *Barriers to competition*: 74.

[77] See recital 54, *Commission Consolidated Jurisdictional Notice under Council Regulation (EC) No. 139/2004 on the control of concentrations between undertakings.* OJ C 95, 16.4.2008.

[78] Christopher Bellamy and Graham D. Child, *European Union law of competition* (Oxford: Oxford University Press, 2018): 529.

[79] Regarding the assessment, see recital 59, *Commission Consolidated Jurisdictional Notice under Council Regulation (EC) No 139/2004 on the control of concentrations between undertakings.* OJ C 95, 16.4.2008.

mon ownership acquisitions in certain markets (oligopoly markets). In these cases, there is no need of additional controlling rights, but the mere presence of an index fund in several undertakings or a more active presence via the right to engage (which is not voting) that may have structural changes in competition, as coordinated effects arise in common ownership cases, even if the concept of control is not reached.

It is also doubtful that various common owners obtain joint control that is defined as "two or more undertakings or persons can control another undertaking".[80] (art. 3. 4 EUMR). This would be the case where various undertakings acquire minority shareholdings in another undertaking that confers them majority of voting rights; if they vote in the same way, it may be qualified as joint control. Still, a *de facto* joint control acquisition may be more plausible when common owners have the same interests.[81] Although the Commission has already disregarded those financial investors or creditors that invest in the same company have common interests, index funds should be treated as an exception because the nature of their investment makes them pursue the long-term objective of companies. Even indirectly they can potentially share common interests when they hire the same proxy advisor and vote as recommended by its report.[82]

The above interpretation faces several challenges. Firstly, in transparency terms, the problem to detect a formal agreement between the parties, or the common interest they share, that prevent them from acting against each other.[83] In addition, the interpretation of joint control in securities acquisitions has been limited to cases where direct links between competitors were found; therefore an extensive interpretation should be applied to catch indirect links such common ownership cases.[84] Another issue is the possibility of a changing coalition, for example, the presence of a hedge fund or another investor that could potentially shift the majority.[85] For all

[80] Ibid., recital 62.

[81] Kokkoris and Shelanski, *EU merger control*: 128.

[82] In this vein, Einer Elhauge, "How horizontal shareholding harms our economy – And why antitrust law can fix it", *Harvard Business Law Review* 10, no. 2 (Summer 2020): 273-275; Monopolkommission, "Common ownership": 21, against this interpretation, see Alec J Burnside and Adam Kidane, "Common ownership: An EU perspective", *Journal of Antitrust Enforcement* 8, no. 3, November 2020: 484.

[83] Bellamy and Child, *European Union*, 534

[84] Elhauge, "How horizontal shareholding": 275.

[85] As the Commission clarified, "the possibility of changing coalitions between minority shareholders will normally exclude the assumption of joint control", see Recital 80, *Commission*

these reasons, common ownership cannot generally fit as a joint control case, but, still, it has been defended that "normally is not always", and a stable coalition among common owners should be considered.[86]

In sum, common ownership cases are not all subject to review under EUMR. The difficulty resides in the rather strict concept of control, which only covers market structure changes but misses intra-undertaking relationships due to the single entity doctrine.[87] The EUMR is missing the prevention of the potential anticompetitive effects that common owners' acquisitions with no control can have in oligopolistic markets.[88] The only remedy available to fill this gap is through Member States' merger regimes that do not follow a similar concept of control.[89] In effect, in *Ryanair*, the Commission demonstrated the incapacity to order the divestiture of a direct holding (or cross-ownership) of the company in *Aer Lingus* due to the fact that the minority holding did not lead to the acquisition of control.[90] On the contrary, the UK Competition Commission (CC) was able to force *Ryanair* to reduce its stake in *Aer Lingus* because the term material

Consolidated Jurisdictional Notice under Council Regulation (EC) No 139/2004 on the control of concentrations between undertakings, (2008/C 95/01).

[86] Elhauge, "How horizontal shareholding": 275.

[87] See Florence Thépot, *The interaction between competition law and corporate governance* (Cambridge, 2019), 78, 96-100 regarding the usefulness of the theory of firm to the application of the single entity doctrine when ownership and control differ: it could help to determine if ownership could be included as a lasting change of control so as to apply EU merger control.

[88] In general, regarding the limitations of EUMR to analyse minority holders, see Fotis and Zevgolis, *The competitive effects of minority shareholdings* (Hart Publishing): 42. Regarding common owners, Anna Tzanaki, "Varieties and mechanisms of common ownership: A calibration exercise for competition policy" (2021), available at SSRN: https://ssrn.com/abstract=3779856: 22, alerted that, from a corporate perspective, in oligopolies, passive investors might not be in competition terms, as their presence may derive competition effects.

[89] The analysis of other regimes that examine minority holdings is beyond the scope of this paper, but the main difference from the EU system is a more flexible approach to control. For example, Germany applies the term "competitively significant influence", which is less strict than the concept of control, but the minority holder (even below the 25% threshold) needs that the influence is acquired via plus factors such as information rights of the operative business of the target. An ample interpretation can also be found in other countries such as in the US: even art. 7 of the Clayton Act is not precise enough to ascertain when an acquisition of shares lessens competition and needs to be notified, but the Hart Scott Rodino Act establishes a 10% safe harbour so acquisitions below that percentage with no engagement purpose (investment only) are exempted of notification. See, for a comprehensive study: Paniagotis Fotis and Nikolaos Zevgolis, *The competitive effects of minority shareholdings* (Hart Publishing): 193-240.

[90] In *Ryanair/AirLingus* (Case T-411/07, EU:T:2010:281), the General Court did not uphold the Commission's decision; as the partial acquisition did not grant control, there was no concentration, and it could not be declared incompatible with the internal market.

influence includes minority holdings without control.[91] In other cases, common ownership acquisitions that constitute minority holdings without control, that have community dimension, are not possible to be examined preventively through EUMR. Only the anticompetitive effects can be resolved ex-post under Arts. 101-102 TFEU, even if they are not the most adequate instruments.[92]

1.2. Minority holdings as structural links or elements of context.

Once concluded that horizonal minority holdings that do not confer control are not subject to review directly under EUMR, they may be considered indirectly as pre-existing shareholdings in the substantive assessment of concentrations under the review of a notified merger.[93]

Structural links (direct links) are minority holdings that parties of a concentration have in the undertakings involved in the operation and in third-party competitors. Even though this link is not indispensable, they might help in the surge or stabilisation of a collective dominance position in an oligopolistic scenario.[94]As the European Commission has underlined, structural links increase transparency as they favour exchanges of strategic information and interests are harmonized.[95] They contribute to facilitating coordination.[96] As a result, the Herfindahl index (HHI) varies when there are significant cross-shareholdings among the market participants and a modified version of the index applies. In this scenario, one particular solution is that the Commission forces to divest the minority shareholdings in order to authorise the merger.

[91] Competition Commission, Final Report, 28 August 2013.

[92] Even the European Commission in its *White Paper towards more effective EU merger control*, 11, concluded that arts. 101 and 102 TFEU were not the best instruments to tackle anticompetitive effects of minority holdings, which has also been noted by authors such as Frank Montak and Mary Wilks, "EU merger review of the acquisition of non-controlling minority shareholdings: Where to now?", *ZWER,* 2, (2015): 83-84.

[93] However, the Commission has no competence to examine minority holdings acquired after the examination of the acquisition of control, see *Commission staff working document accompanying the document White Paper towards more effective EU merger control*, recital 45.

[94] Luis Ortiz Blanco, *Market power in the EU antitrust* (Hart, 2016): 190. However, Kai-Uwe Kuhn, "An economists' guide through the joint dominance jungle" (July 2001), available at SSRN: https://ssrn.com/abstract=349523: 20, alerts to the contrary: structural links could reduce collusion, particularly in asymmetric cases (when one firm owns a share in a competitor but not the opposite).

[95] For a comprehensive study, see Schwalbe, Ulrich and Daniel Zimmer, *Law and economics in European merger control*, 2009: 254.

[96] In M.1673-Veba/Viag, the Commission underlined that the Veba and Viag merger, in conjunction with the RWE and VEW merger, could have led to coordinated behaviour.

Indirect links between companies such as common ownership cases have also been taken into consideration by the Commission. Indeed, in *Bayer/Monsanto* the Commission declared common ownership an "element of context of any significant impediment to effective competition" in mergers review, concluding that the theories of harm applied to structural links are extended to common ownership scenarios, as they have the same effect, which is making structural changes to the market.[97] In this vein, in *Dow/Du Pont*, the Commission also considered the effects of common ownership in innovation to conclude that in agrochemical industries that share the same shareholders, the competition in innovation on crop protection was reduced due to the presence of common owners if compared to industries that do not have these links.[98]

In the end, the Commission's interest on common ownership implies that horizontal minority shareholdings have more control than their equity share suggests. However, it is questionable that direct structural links produce the same effects as indirect structural links (common ownership) in order to justify the application of the modified HHI to the latter cases as well. In fact, its accuracy to measure coordinated effects and common ownership has not been unanimously accepted[99], mainly when products are heterogeneous.[100]

In conclusion, the EUMR regime only considers common ownership as a mere element of context in mergers under review, in contrast with other jurisdictions, where merger regimes also apply to initial minority acquisitions that do not confer control. The only path available to restrain the anticompetitive effects of common ownership is through antitrust enforcement. To this end, it is examined whether engagement techniques of institutional investors may represent an infringement of art. 101 TFEU as a facilitating device for competitors to coordinate their conducts. It can

[97] "Common shareholding in these industries (18 common shareholders are enough to reach, collectively, between 18% and 34% shares in all of these firms, and in particular 34.81% of DowDuPont and 29.28% of Monsanto) are to be taken as an element of context in the appreciation of any significant impediment to effective competition that is raised in this Decision", M.8084 – *Bayer/Monsanto*.

[98] M.7932.

[99] See a discussion in Tilman Kuhn, "The 15th anniversary of the SIEC test under the EU Merger Regulation – Where do we stand? (Part 1)", *ZWeR* 1, (2020) who considered the approach of the Commission as "overreaching" in Bayer/Monsanto.

[100] But other measures applied. For example, Azar, Raina, Schmalz, "Ultimate ownership": 3, considered a generalized HHI (GHHI) that captures common ownership as well as cross ownership.

be advanced that it is cumbersome to gather indicia that link investors' voices to coordination of competitors because there is no detailed information in their engagement policies. Furthermore, it needs to be considered that there is no need of an active conduct by institutional investors, their presence as passive owners may generate tacit collusion (conscious parallelism) under art. 102 TFEU.

2. Antitrust enforcement

2.1. Hub & spoke through engagement

The acquisition of a minority holding as such does not restrict competition, it may only infringe art. 101 TFEU if it is part of an agreement that has the object or the effect of restricting competition.[101] Despite its limited scope, it cannot be missed that a minority holding could help coordinating competitors conduct that do fall under art. 101 TFEU.[102] Precisely, in common ownership cases, the reconcentration of power in the hands of index funds might ease facilitating practices in connection with collusion[103]. The presence of common owners could be used to disclose information, so common ownership could potentially facilitate coordination through engagement[104]. In Europe, where SRD II is promoting engagement, there is a rising tension between more engagement and its anticompetitive effect[105].

In fact, their engagement could qualify as a successful indirect information exchange between competitors, which is explained in the *Guidelines on horizontal cooperation agreements*: "data can be shared indirectly through a common agency (for example, a trade association) or a third

[101] *White Paper towards more effective EU merger control (Text with EEA relevance)* /* COM/2014/0449 final */.

[102] Fotis and Zevgolis, *The competitive effects*: 90.

[103] Menesh S. Patel, "Common ownership, institutional investors, and antitrust", *Antitrust Law Journal* 82, no. 1 (2018): 44 (ssrn version).

[104] Einer Elhauge, "How horizontal shareholding harms our economy – And why antitrust law can fix it": 8.

[105] As underlined in the study of Frazzani, Noti, Schinkel, Seldeslachts, Banal Estañol, Boot and Angelici, *Barriers to competition*: 100, when referring to institutional investors talks with management as appropriate to increase engagement promoted in the SRD II, but also warning about the dilemma that gives title to this paper: "on the one hand, of desirable institutional investors' disclosure to foster corporate governance oversight, and, on the other, of an undesirable impact on competition in the relevant market materialising in anticompetitive conduct".

party such as a market research organisation or through the companies' suppliers or retailers".[106]

These exchanges of information are commonly known as hub & spoke practices. Coordination is reached indirectly through the hub, which acts as a facilitator as well as the enforcer of the colluding behaviour. The hub artificially increases the transparency of the market and contributes to ease parallel behaviour between competitors, as strategic uncertainty is diminished.[107] However, the success of the hub depends on the characteristics of the market and on the type of information disclosed[108] and it has been considered more powerful than public information exchanges due to the amount of information exchanged and the fast reaction that competitors can have.[109] The vital point to consider whether a concerted practice is taking place is the nature of the data share: if strategic data is shared between competitors, it is a concerted practice, as "it reduces the independence of competitors' conduct on the market and diminishes their incentives to compete".[110]

In common ownership cases, the third party in the definition provided by the Guidelines could be the common owner that shares strategic information indirectly, reducing market uncertainty. In addition, the fact that there could be more than one common owner not only helps to coordinate their objectives regarding performance or management, but they gain a powerful voice in the company as well, as it is easier to disseminate the strategic information.[111] Furthermore, even if it is not the scope of the paper, as we focus on the preludes of the influential mechanisms of institutional investors, another governance mechanism of index funds is the appointment of a director when there are higher levels of common ownership. This director could potentially act as a conduit (a cartel ringleader or

[106] *Guidelines on the applicability of Article 101 of the Treaty on the Functioning of the European Union to horizontal co-operation agreements,* 2011/C 11/01.

[107] Richard Whish and David Bailey, *Competition law* (Oxford University Press, 2018): 581.

[108] Recital 58, *Guidelines on the applicability of Article 101 of the Treaty on the Functioning of the European Union to horizontal co-operation agreements*, 2011/C 11/01.

[109] Itai Rabinovici, "Public exchange of information after container shipping", *Journal of European Competition Law & Practice* 8, no. 3 (2017): 149-156.

[110] Recital 61, *Guidelines on the applicability of Article 101 of the Treaty on the Functioning of the European Union to horizontal co-operation agreements*.

[111] Coates, "The future of corporate governance": 15-16.

organiser) in a phase of stabilisation and be able to monitor and punish cheating.[112]

All in all, the problem is the lack of evidence about the use of engagement of institutional investors to share strategic information between the spokes (the companies in the same industry) through the hub (the common owner) aside the information that might be obtained through leniency applications. However, it has also been suggested that no more evidence is needed than the mere presence of common owners to consider a colluding behaviour, because companies are indirectly linked via shareholders, so they will not behave independently.[113] This interpretation is based on the *Phillip Morris* case, regarding the role of minority holdings' influence in coordination cases.[114] Thus, this interpretation is quite loose, as indirect links are not deemed enough to determine concertation and the causal link needs to be detected.[115] As underlined in *Woodpulp*, evidence of concertation is needed unless parallel behaviour could serve as such when concertation is "the only plausible explanation for the conduct".[116]

In sum, the presence of common owners is weak evidence for proving that collusion has been reached through a hub and spoke engagement mechanism. It is difficult that it could qualify as an infringement of art. 101 TFEU without the necessary proof. The solution could come from a reform of the SRD II to gather more details of how they develop their engagement policy, precisely if strategic information about the companies is discussed in private meetings where engagement takes place, and that information is passed to other companies.

2. 2. Passivity of institutional investors and collective dominance

Once it has been considered that the proactive engagement of common owners might be an infringement of art. 101 TFEU, it is necessary to

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[112] Patel, "Common ownership": 45; Rock and Rubinfeld., "Common ownership": 19, Frazzani, Noti, Schinkel, Seldeslachts, Banal Estañol, Boot and Angelici, *Barriers to competition*: 89.

[113] Elhauge, "How horizontal shareholding": 276.

[114] Judgment of the Court of 17 November 1987, *British-American Tobacco Company Ltd and R. J. Reynolds Industries Inc. v. Commission of the European Communities*, Cases 142 and 156/84, EU:C:1987:490.

[115] On the contrary, Alec J Burnside and Adam Kidane, "Common ownership: An EU perspective", *Journal of Antitrust Enforcement* 8, no. 3, November 2020: 484, Frazzani, Noti, Schinkel, Seldeslachts, Banal Estañol, Boot and Angelici, *Barriers to competition*: 81.

[116] Judgment of the Court of 31 March 1993, *A. Ahlström Osakeyhtiö and others v. Commission of the European Communities*, Cases C-89/85, C-104/85, C-114/85, C-116/85, C-117/85 and C-125/85 to C-129/85, EU:C:1993:120.

determine whether passivity of common owners is under the scope of art. 102 TFEU.

Generally, a minority holder is subject to this article if the position is dominant and constitutes and abuse.[117] As a result, minority holdings' acquisitions as such do not normally infringe this disposition due to their characteristics.[118] Nevertheless, the presence of a minority holder, such as the common owner, could help to develop tacit collusion between competitors of an oligopolistic market without proactively engaging in the companies.[119] In effect, common owners' passivity might be interpreted as a signal for directors to compete less aggressively. As a result, omission of engagement could be a way to decrease competition too, even if it is done unconsciously by common owners.[120]

Collective dominance was defined in *Compagnie Maritime Belge Transports v. Commission*[121] as the situation where independent companies present themselves or act together as a collective entity. In this case, it is necessary to examine economic links between companies to ascertain whether a collective dominance position has occurred.[122]

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[117] In Case 6/72, *Europemballage Corporation and Continental Can Company Inc. v. Commission of the European Communities* (EU:C:1973:22), it was underlined that the acquisition of a shareholding in a competing company (cross-ownership) by an undertaking that holds a dominant position may amount to an abuse when the position is strengthened through a merger.

[118] White Paper towards more effective EU merger control (Text with EEA relevance)/* COM/2014/0449 final */.

[119] Omission of engagement could be a way to decrease competition as well, even if it is done unconsciously, see Schmalz, "Common-ownership concentration and corporate conduct", *Annual Review of Financial Economics* 10, December 2018, *CESifo Working Paper* Series no. 6908 (2018): 20; OECD, *Background note on common ownership*, DAF/COMP(2017): 21.

[120] Schmalz, "Common-ownership concentration and corporate conduct", *Annual Review of Financial Economics* 10, December 2018, *CESifo Working Paper* Series no. 6908 (2018): 20.

[121] Judgment of the Court of 16 March 2000, *Compagnie maritime belge transports SA (C-395/96 P), Compagnie maritime belge SA (C-395/96 P) and Dafra-Lines A/S (C-396/96 P) v. Commission of the European Communities*. EU:C:2000:132.

[122] As well as in the Italian flat glass case (Judgment of the Court of First Instance (First Chamber) of 10 March 1992, *Società Italiana Vetro SpA, Fabbrica Pisana SpA and PPG Vernante Pennitalia SpA v. Commission of the European Communities*, EU:T:1992:38), confirming the presence of economic links between companies to determine the collective dominance as in the Bosman case (Judgment of the Court of 15 December 1995, *Union royale belge des sociétés de football association ASBL v. Jean-Marc Bosman, Royal club liégeois SA v. Jean-Marc Bosman and others and Union des associations européennes de football (UEFA) v Jean-Marc Bosman*, EU:C:1995:463), where the Commission considered football clubs were united by such economic links that can hold a collective dominance position, but the decision was upheld because of lack of the necessary proof.

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Yet, the term has evolved to consider connecting factors when evaluating a dominant position, as it derived from *France v. Commission*[123]. This term is more flexible than economic links and brings the possibility to consider shareholder links. In common ownership cases, collective dominance is reinforced through the indirect structural links that common owners represent, and that it may lead to excessive pricing without the need for an explicit behaviour. In this setting, there is no need to prove the agreement between the parties about excessive prices, but to show that the presence of common owners gave rise to a collective dominance situation between the firms affected, which led to excessive pricing.[124]

Despite this useful interpretation to tame the adverse effects of common ownership, which would sanction those cases that EUMR is unable to review, no case yet connects the surge of collective dominance with common ownership investments. For instance, in *Airtours*, the presence of institutional investors in the companies (*Airtours, First Choice, Thomson*) did not qualify as evidence "that there is already a tendency to collective dominance in the industry".[125]

As a result, the presence of common owners does not constitute an abuse, and the mere parallel conduct of companies is not unlawful per se.[126] Nevertheless, it might be considered the effect of common owners' tactics to influence directors indirectly without coordinating or communicating, for example, by promoting compensation linked to industry performance or siding with management against activists proposals.[127] Even when the potential link that determines fixing parallel prices is detected, it is not sufficient to fall under art. 102 TFEU, but the *United Brands test*

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[123] Judgment of the Court of 31 March 1998, *France and Société commerciale des potasses and de l'azote and Entreprise minière and chimique v. Commission*, C-68/94 and 30/95, EU:C:1998:148.

[124] Elhauge, "How horizontal shareholding": 278-279, against this view, see Burnside and Kidane, "Common ownership": 500.

[125] Judgment of the Court of 6 June 2002, *Airtours plc v. Commission of the European Communities*, T-342/99, EU:T:2002:146.

[126] "Parallel conduct cannot be regarded as furnishing proof of concertation unless concertation constitutes the only plausible explanation for such conduct", in Judgment of the Court (Fifth Chamber) of 31 March 1993, *A. Ahlström Osakeyhtiö and others v. Commission of the European Communities*, C-89/85, C-104/85, C-114/85, C-116/85, C-117/85 and C-125/85 to C-129/85, EU:C:1993:120.

[127] Einer R. Elhauge, "The causal mechanisms of horizontal shareholding", *Ohio State Law Journal* 82, no. 2 (2021): 12, 18 (ssrn version).

on unfairly high prices should be passed.[128] Yet, it is unlikely that the Commission would consider this case as acting as price regulator.[129] And the second burden of this case is to justify that the mere presence of common owners is sufficient to hold them responsible for the anticompetitive infringement of other undertakings (the portfolio companies).[130]

V. Regaining balance between governance and antitrust: Proposals against adverse effects of common ownership

1. A more detailed and transparent index fund engagement

One of the limitations of competition authorities to prosecute companies that sustained coordinated practices due to the presence of common owners is the lack of evidence that connects engagement with coordinated effects. As several comments have pointed out, engagement transparency should be the starting point to overcome the adverse effects of horizontal shareholdings.[131]

For making it possible, once engagement is the primary governance mechanism used by institutional investors, a revision of the SRD II might be considered in Europe by the European Commission.[132] A more detailed engagement policy is needed. The information provided should include the number of meetings with the companies, who approached whom, the

[128] Judgment of the Court of 14 February 1978, *United Brands Company and United Brands Continental BV v. Commission of the European Communities*, Case 27/76, EU:C:1978:22.

[129] Whish and Bailey, *Competition law*, 565-566.

[130] In general, regarding the liability of shareholders, see Stephen Kinsella and Anouck Meier Sidley Austin, "Why shareholders should not share the blame in the EU", *GCP Antitrust Chronicle*, Nov. 2009, which rejected the extension of liability to companies whose only connection with the infringement is being the owners of shares in a cartel that forms part of a cartel. Okeoghene Odudu and David Bailey, "The single economic entity doctrine in EU competition law", *Common Market Law Review* 51, 2014: 1753 also underlined that a shareholder might be held liable as to recover the gains that he obtained due to the infringement of competition by other companies. In the context of common ownership, see Burnside and Kidane, "Common ownership": 43.

[131] Vanguard has coined its approach to firms "quiet diplomacy". However, the need for more transparency is advocated, see: Bebchuk and Hirst, "Index funds": 2123; Schwalbe, "common ownership and competition", 603. Although others consider that more transparency would be the end of engagement, see Ahern, "The mythical value of voice": 106-107.

[132] The European Commission subject to Art. 3 k of Directive (EU) 2017/828 shall submit a report to the European Parliament and Council on the implementation of Articles 3g, 3h and 3i which refer to engagement and investment policies. This report can be accompanied by legislative proposals.

changes that the fund solicited, or the information that the company gave to the investor.[133]

As an alternative to the reform of the SRD II, Governance Codes could guide better about the dialogue with shareholders[134]; but, in any case, companies should implement robust antitrust compliance programmes.[135]

2. A digitalised merger control review of minority holdings

If engagement of institutional investors becomes more transparent, common ownership cases will be easily detected but will not prevent coordinated effects take place. This solution has been already considered by the European Commission in the *White paper towards more effective EU merger control* to catch non-controlling minority holdings due to the poor ex-post control of minority holdings.[136]

That proposal shall be revisited due to the minimum margin of the Commission to examine common ownership cases at the moment.

[133] Other alternatives to increase transparency are, for example, in the US, Bebchuk and Hirst, "Index funds": 2124, who believe that detailed information should be included under Regulation FD. Still, flaws to meet that purpose have also been underlined the in Bengtzen, Martin, "Private investor meetings in public firms: The case for increasing transparency", 22 *Fordham J. Corp. & Fin. L.* 33 (2017): 239. In Europe, Strampelli, "Knocking at the boardroom door", alerted that, as it had been done with market soundings in art. 11 MAR, companies shall be required to keep the records of the meetings with shareholders.

[134] In this sense, Dionisia Katelouzou and Konstantinos Sergakis, "When harmonization is not enough: Shareholder stewardship in the European Union", *Eur Bus Org Law Rev* 22 (2021): 220-222, 236; also Strampelli, "Knocking at the boardroom door": 18 defends the role of Governance Codes and Stewardship Codes on developing detailed engagement due to the rather literal transposition of the SRD II, which leaves ample scope to these codes to tailor engagement.

Some examples about developing the dialogue in Codes are the Belgian Code Art. 8.1.: "8.1 The board should ensure an effective dialogue with shareholders and potential shareholders through appropriate investor relation programmes, in order to achieve a better understanding of their objectives and concerns. Feedback of such dialogue should be given to the board, on at least an annual basis. Also in the Spanish Code, recommendation 54, which establishes that a committee supervise the compliance with the polices and rules of in corporate governance, one of its functions should monitor the implementation of a general policy regarding the communication with shareholders, investors, proxy advisors or stakeholders. As well the committee should monitor the communication with small and medium sized shareholders. It had been noted that the engagement policies in some cases were focused on the general meeting and voting rather than in a broader sense, see Fernández Torres, Isabel, *Las loyalty shares: Cortoplacismo contra activismo accionarial* (Marcial Pons, 2017): 138-142.

[135] Schmalz, Martin C., "Common-ownership concentration": 29; Rock and Rubinfeld, "Common ownership": 38.

[136] Highlighted in the European Commission's *White Paper towards more effective EU merger control*, COM/2014/0449 final (2014): 11.

Common ownership cannot only be referred to as an "element of context", as it was interpreted in *Dow/DuPont* (2017) and *Bayer/Monsanto* (2018), because the effects of its presence are directly suffered by consumers, as higher prices are connected to common ownership.

As a consequence, it is necessary to close the enforcement gap in Europe regarding minority holdings that do not confer control but have substantial influence.[137] In particular, the hybrid option ("a targeted transparency system") chosen by the European Commission in the White Paper shall be implemented. As a result, it is necessary to change the concept of control to review those transactions with a "competitively significant link".[138] A cumulative criterion shall be reached by a minority acquisition to be considered a significant link: the acquisition of a minority shareholding in a competitor, which includes indirect structural links as common ownership cases[139]. On the other hand, it needs to qualify as a "competitively significant link". This means transactions above 20% or less than 20% but above 5% "which give the acquirer 'de-facto' blocking minority, a seat on the board of directors, or access to commercially sensitive information of the target".

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[137] In the same vein, Florence Thépot, *The interaction between competition law and corporate governance* (Cambridge, 2019), 94-100 described the differences between the US and EU systems and how the US system is more adequate because the focus is not on market-firm relationships, but anticompetitive effects of minority holdings, whether or not they confer control. Also, Anna Tzanaki, "Varieties and mechanisms of common ownership: A calibration exercise for competition policy" (2021), available at SSRN: https://ssrn.com/abstract=3779856:96, defending the need to revise the definition of joint control in EUMR. But Fotis and Zevgolis, *The competitive effects*, 349 alerted that such a reform would entail more problems than solutions due to the insignificant cases in this matter. In the same vein, warning about the effects that such a change could entail in national regimes, Gassler, Martin, "Non-controlling minority shareholdings and EU merger control", *World Competition*, 41, no. 1 (2018): 41. Another alternative could be to consider the implementation of the market investigation tool that UK applies, see Fritz Schumann, *Die Behandlung von tacit collusion im europäischen und deutschen Kartellrecht* (Nomos, 2017). In the US, Posner, "Policy implications": 148 considered that a reform of the merger control (reducing HHI threshold) in the US is not a good solution in the short and medium term due to highly concentrated markets.

[138] It has also been suggested incorporating a definition of common ownership in the merger control regime, Natalie Seitz, *Common ownership im Wettbewerbsrecht* (Nomos, 2020) or to include "non-controlling minority shareholdings" in the meaning of concentration, Verdeguer Segarra, Miguel, *Non-controlling minority shareholdings under EU Competition Law* (Aranzadi, 2019), 78.

[139] As the European Commission underlined, it captures: "an acquisition of a minority shareholding by one company which itself does not compete with the target, but which already holds a minority stake (or more) in one or more other firm(s) competing with the target", see *Commission staff working document Accompanying the document White Paper towards more effective EU merger control*, footnote 67, SWD(2014) 221 final.

The problem with the Commission's approach is that common ownership cases could fall below the 5% threshold and still have anticompetitive effects. A third exception should therefore be included in common ownership scenarios: horizontal minority holdings below 5% in the same industry with oligopoly structure shall be revised case by case, as common ownership in these cases might facilitate coordination between competitors.[140] This proposal is similar to the reform proposal of the Federal Trade Commission in the US. If the reform takes place, common ownership anticompetitive effects will be reduced, as the proposal requires premerger notification of acquisitions of less than 10% when the acquiror has of 1% of the outstanding voting securities of any entity that is a competitor of the issuer.[141]

Regarding the procedure to notify minority holdings' transactions with a competitively significant link, it will face less administrative burdens than its implementation may have encountered.[142] Nowadays, there is an instrument that was not available when the European Commission White Paper was conducted, which is the use of innovative technology by supervisory agencies (SUPTECH), as the application of distributed ledger technology.[143] Under the transparency system proposed, smart contracts might help the automatic assessment of minority holdings, and those holdings that might cause anticompetitive effects can be revised personally by the authorities when the smart contract raises a red flag.

3. An alternative: Powerless index fund regimes

If the EUMR is not modified, an alternative thereto is to consider some reforms of the index fund regimes.

One of the possibilities is to revise the investment pattern of index funds to limit the reconcentration of power.[144] As a result, the diversifica-

[140] Defending a case-by-case evaluation, Patel, "Common ownership": 8.

[141] Premerger Notification; Reporting and Waiting Period Requirements, FTC-2020-0085-0001.

[142] However, this argument was dismissed in Spark Legal Network and Queen Mary University of London, *Support study for impact assessment concerning the review of merger regulation regarding minority shareholdings*, 2016, 10 to encourage the EU Commission to consider the implementation due to the inability of Member States to review them and to the fact that the administrative burden is not likely to arise, as there have been few cases.

[143] In favour of innovation technologies for data reporting, see: Dirk Broeders, and Jermy Prenio, "Innovative technology in financial supervision (suptech) – The experience of early users", *FSI Insights* 9 (2018): 7.

[144] It has been alerted that targeting the pattern of index funds would only be discriminatory, as they are treated differently from other shareholders, see Jennifer G. Hill, "The conundrum of common ownership", *European Corporate Governance Institute – Law Working Paper* no. 500 (2020): 28.

tion rules that are applicable to passive institutional investors should be restricted. Instead of limiting their holding in every company to a certain percentage, their investment should be limited to a company per industry. In this vein, the advantages of having an institutional investor in governance terms could not be missed completely, as their stewardship would be concentrated in one company instead of the whole industry and the anti-competitive effects of common ownership would be reduced.[145] Likewise, it has been specified that the holding should be no more than 1% of the total shares of the firm in an oligopoly, unless the index fund commits to have passive investment behaviour.[146] This proposal has considerable drawbacks. On the one hand, the limitation of common ownership would have negative effects: it would undermine their portfolio diversification nature and could diminish the positive role that index funds have on market-based corporate finance. On the other hand, it could diminish the role that they have in corporate governance.[147]

Another alternative, which has been suggested in the US, is the reversal of the advocacy of institutional investors, in the sense that SEC shall recommend this type of holders to remain passive when they have significant holdings. The drawback of this perspective is that asset managers manage not only passive funds, but active funds as well, so divestitures should be needed.[148] Furthermore, in Europe, this perspective will be quite burdensome because the principle of engagement of institutional investors has been reinforced by SRD II.

Given the downsides of the previous proposals to reduce the power of index funds, the solution might be to deconstruct the aggregate voting power conferred to asset managers. Whereas asset managers vote the shares that are owned by the funds as a whole package, the proposal is to apply a pass through approach as to force each fund to vote[149]. This approach could be taken a step further in order to allow the possibility

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[145] Elhauge, "The causal mechanisms": 62.

[146] Posner; Eric A., Fiona M. Scott Morgan; E. Glen Weyl, "A proposal to limit the anticompetitive power of institutional investors", *Antitrust Law Journal* 81, no. 3 (2017): 708; John C. Bogle, *Stay the course: The story of Vanguard and the Index Revolution* (Wiley, 2019): 247.

[147] Alerting about the drawbacks, MonopolKommission: 32.

[148] Eric A. Posner; Fiona M. Scott Morgan; E. Glen Weyl, "A proposal": 722.

[149] Jill E. Fisch, "The uncertain stewardship potential of index funds", in *Global shareholder stewardship: Complexities, challenges and possibilities* (Dionysia Katelouzou & Dan W. Puchniak eds., Cambridge University Press, forthcoming): 120.

for fund beneficiaries to vote.[150] With this solution, in the end, the right to vote is exercised by the beneficiaries, who bear the risk of their investments' savings for retirement but also suffer price rises as consumers as well. Thus, there is the risk that passivity of investors increases as it will even more difficult that retail investors engage in the companies.

If it is not implemented, the fiduciary duty of institutional investors should be revisited. SRD II is an example in this line, as institutional investors' interests shall encompass broader interests. However, it is needed to depict a concrete fiduciary duty of these institutions must be depicted. Not only do they need to put the interest of their beneficiaries first as prospective retirees, but they need to think of beneficiaries in a larger extent, namely as consumers, because softening competition strategies also impacts them with higher prices.[151]

V. Concluding remarks

Common ownership is an investment pattern found in certain investors such as index funds. Even if they do not obtain a control position due to their diversification ratios, their involvement might lead to softening competition in certain oligopolistic industries as they hold shares of every company included in the index. Companies can be helped by minority holders as facilitators of coordinated practices, either through active engagement, which might constitute hub and spoke practices, or passivity, which leads to tacit collusion.

In any of the aforementioned cases, the problem of antitrust authorities is to ascertain these conducts due to the lack of evidence of the role they play in reducing competition. It is necessary to consider how to reconcile the positive side of engagement in general terms and the negative impact in concentrated markets. More transparency and detailed engagement are needed, but merger control in Europe should be revisited as well, given the influence that non-controlling minority holdings have in competitive terms.

In the meantime, an intermediate solution, which does not limit stewardship and the investment patterns of index funds, could be to confer the beneficiaries of funds, at least, the right to vote. In the end, they bear the consequences of anticompetitive practices as consumers as well.

[150] See my previous work on decoupling, Luz Mª García Martínez, *Nuevas formas de ejercicio del voto: La ruptura del binomio riesgo-poder en sociedades cotizadas*, Aranzadi, 2019, 385.
[151] Bogle, *Stay the course*: 251, 254.

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