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Common Ownership: "Puffery" in the Legal Analysis

By Mike McNamee

The claim that competition in a concentrated industry suffers when institutional investors own shares in several companies in that industry continues to garner attention, as advocates pen op-eds and seek press attention. But as more and more experts examine "the common ownership story," critical commentary is tearing large holes in this claim. Both the theoretical and empirical bases for this "story" are looking increasingly threadbare.

Proponents of the common ownership hypothesis presume—based on three hotly contested papers—that the economic debate over the competitive effects of institutional investing is settled. So they charge headlong into ways to apply antitrust law—and here, too, they assume an open-and-shut case, arguing that the Sherman and Clayton acts and relevant case law provide clear direction on how to rein in asset managers and institutional investors that, on behalf of their clients, hold shares in competing companies within concentrated industries.

"Common Sense About Common Ownership" cries foul on both of those assumptions. In their paper, Douglas H. Ginsburg, judge on the US Circuit Court of Appeals for the District of Columbia Circuit, and Keith Klovers, a judicial clerk on that court, find that those proponents "substantially overstate the validity and strength of the existing empirical work" on common ownership.

"For every study finding anticompetitive effects, there are three refuting it." Yet, Ginsburg and Klovers note, most proponents "simply assume a causal relationship" between common ownership and competitive effects. The proponents' approach, the authors conclude, "puts the legal cart before the economic horse."

And that legal cart is missing a few wheels. Ginsburg and Klovers point to a fundamental problem: proponents of antitrust action take cases that focus on cross ownership—where one company in an industry owns a significant stake in the stock in a competitor—and claim that those cases apply to common ownership, the proponents' term for institutional investors' management of small stakes in competing companies.

The two are not equivalent, Ginsburg and Klovers say. "An individual who owns stock in all four major airlines might well benefit if those airlines successfully increased their ticket prices," they note. "In contrast, an index fund holding the four airlines and the 496 other components of the [Standard & Poor's] 500 would experience not only that gain but also…losses in other shares it owns"—because those 496 other companies face higher prices as customers of the airlines, and because some of those other companies are suppliers to airlines, or operate related businesses that suffer if air travel is more expensive.

"The incentives arising from cross ownership are much simpler—and much more likely to be anticompetitive—than those arising from common ownership," Ginsburg and Klovers write. "Therefore, court decisions premised on cross ownership do not necessarily apply, let alone apply with equal force, to common ownership."

Courts have indeed ruled in several cases that cross ownership can create liabilities under the antitrust laws, the authors say. But the parallels that proponents try to draw between these cases—when one competitor directly owns a stake in another—and common ownership are so strained that "none of the cases actually supports" the proponents' legal views.

"Shorn of puffery," the proponents' legal argument "is not supported by any authority beyond a simple reading of the statute"—ignoring the substantial body of case law interpreting those statutes—and "the hotly contested empirical results," Ginsburg and Klovers say.

The authors note that this view seems to be shared by the Federal Trade Commission and the Department of Justice. In their joint note on common ownership last year to the Organisation for Economic Co-operation and Development, those agencies said that any antitrust action based on common ownership would require “compelling evidence of the anticompetitive effects of common ownership.” As Ginsburg and Klovers demonstrate, there’s no such evidence on the horizon.

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