NEW EVIDENCE, PROOFS, AND LEGAL THEORIES ON HORIZONTAL SHAREHOLDING

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When the leading shareholders of horizontal competitors overlap, horizontal shareholding exists. In my initial *Harvard Law Review* article on horizontal shareholding, I showed that economic theory and two industry studies indicated that high levels of horizontal shareholding in concentrated product markets can have anticompetitive effects, even when each individual horizontal shareholder has a minority stake.[1] I argued that those anticompetitive effects could help explain longstanding economics puzzles, including executive compensation methods that inefficiently reward executives for industry performance, the historic increase in the gap between corporate profits and investment, and the recent rise in economic inequality.[2] I also showed that when horizontal shareholding has likely anticompetitive effects, it can be remedied under Clayton Act §7.[3] I recommended that antitrust agencies should investigate any horizontal stock acquisitions that have resulted or would result in an ΔMHHI (a measure of horizontal shareholding levels) that exceeds 200 and an MHHI (a measure of product market concentration level with horizontal shareholding) that exceeds 2500, in order to determine whether those horizontal stock acquisitions raised prices or were likely to do so.[4]

My claims have all been hotly contested. However, new proofs and empirical evidence strongly confirm my economic claims.[5] One new economic proof establishes that, if corporate managers maximize either their expected vote share or re-election odds, they will maximize a weighted average of their shareholders' profits from all their stockholdings and thus will lessen competition the more that those shareholdings are horizontal, even if each horizontal shareholder has a minority stake. Another new economic proof shows that with horizontal shareholding, corporations maximize their shareholders' interests by increasing the extent to which executive compensation is based on industry performance, rather

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[1] Elhauge, *Horizontal Shareholding*, 129 HARVARD LAW REVIEW 1267, 1267-78 (2016), https://ssrn.com/abstract=2632024.
[2] *Id.* at 1278-1301.
[3] *Id.* at 1301-1316.
[4] *Id.* at 1303.
[5] Elhauge, *New Evidence, Proofs, and Legal Theories on Horizontal Shareholding* at Part II, https://ssrn.com/abstract=3096812.

than individual firm performance. Neither new proof requires any communication or coordination between different shareholders, between different managers, or between shareholders and managers.

These new economic proofs have been confirmed by two new cross-industry empirical studies.[6] One of them shows that increased horizontal shareholding does make executive compensation inefficiently based more on industry performance and less on firm performance, just as the economic proof predicts. The other new cross-industry study shows not only that the recent historically large gap between corporate investment and profits is driven by horizontal shareholding levels in concentrated markets, but also that within any industry, the investment-profit gap is driven by those firms with high horizontal shareholding levels.

I further provide new analysis demonstrating that various critiques of the two earlier industry studies are meritless.[7] Those two industry studies found that horizontal shareholding had adverse price effects in concentrated airline and banking markets. They have been critiqued in other articles, some funded by the sort of institutional investors that have large horizontal shareholdings. A few of these critiques are valid, but as I show, addressing the valid critiques actually ***increases*** the estimated price effects. The lions' share of these critiques are invalid. For example, some rest on endogeneity claims that are flatly contradicted by the evidence. Another critique uses purported proxies for horizontal shareholding that are actually negatively correlated with horizontal shareholding and uses market models that wrongly assume longer airline routes have lower costs. Other critiques rely on erroneous shareholding data, ignore actual market shares, exclude the transactions most likely to have price effects, and wrongly set many horizontal shareholding rights to zero.

Nor is there any merit to various arguments for delaying any enforcement action.[8] The economic proofs are powerful, the cross-industry studies generalize the empirical findings beyond the two industry studies, the critiques of those two industry studies have proven invalid, fiduciary duties cannot constrain the anticompetitive effects of horizontal shareholding, and the principle of "first do no harm" counsels for intervening to prevent the enormous harm that is now occurring. Further, I rebut the claim that horizontal shareholding cannot have anticompetitive effects because index funds lack incentives to exert effort. I show that, to the

[6] *Id.*
[7] *Id.*
[8] *Id.*

contrary, economic theory indicates that index funds have strong incentives, which are confirmed by the empirical evidence that indicates their efforts are strong and effective. Further, I show that in any event horizontal shareholdings are generally held by actively-managed funds or by fund families that combine different types of index funds with actively-managed funds.

I also provide new legal theories for tackling horizontal shareholding.[9] I show that when horizontal shareholding has anticompetitive effects, it not only violates Clayton Act §7, but also violates Sherman Act §1. The very name of the legal field – anti*trust* law – comes from the fact that the Sherman Act aimed to prohibit certain trusts that were in fact horizontal shareholders in competing firms. It has thus always been the case that horizontal shareholding by a common shareholder is an agreement or combination covered by Sherman Act §1.

I further show that EU competition law can also tackle horizontal shareholding.[10] As I show, although EU merger control law is narrower than Clayton Act §7, EU law's prohibition of anticompetitive agreements and concerted practices under Article 101 of the Treaty on the Functioning of the European Union (TFEU) is at least as broad as Sherman Act §1's prohibition of anticompetitive agreements, and is thus broad enough to condemn anticompetitive horizontal shareholding. Even broader is EU law on collective dominance and excessive pricing under TFEU Article 102, which provides a straightforward solution to the problem of horizontal shareholding.

[9] *Id.* at Part III.
[10] *Id.*