



Institutional Investor Shareholdings Come Under European Commission Scrutiny

IN SHORT

The Situation: A recent study examining common corporate shareholdings in the United States argues that the holding of even minority stakes in rival companies by institutional investors affects competition. The European Commission is considering whether the same could apply under European Union competition law.

The Analysis: EU competition law has tools in place to scrutinize minority shareholdings. The EU Merger Regulation can capture minority shareholding acquisitions when they confer control, and minority shareholdings are included in the Commission's merger analyses. Existing competition laws also address unlawful coordination between competitors where facilitated by common shareholders or directors.

Looking Ahead: Despite the availability of existing tools to address any concerns, the Commission may take enforcement measures, such as a sector inquiry or investigations into particular investors, to test this theory of harm.

EU Competition Commissioner Vestager recently called for scrutiny of the effect of institutional investors holding stakes in multiple companies in the same industry. Her comments follow a 2016 *Harvard Business Review* article observing that three private equity funds hold significant stakes in competing U.S. airlines and banks. The study argued that rival companies with such common shareholders may be less incentivized to compete with each other.

Commissioner Vestager's speech reflects the conclusions of the Harvard study. She indicated that the Commission is examining "whether this sort of common ownership is really common in practice.... [T] here was an assumption that companies acted independently ... but that picture of our markets might not always be right. [I]t's becoming more common for the same investors to hold shares in different companies in the same industry. And for those investors, fierce competition might not seem so appealing."

The Commission has several options. If it examines this issue as a matter of competition policy, it can dedicate a staff unit to it and/or launch a sector inquiry (generally leading to significant involvement by the relevant stakeholders). Another possibility would be to identify a test case to pursue in an enforcement action.

Before deciding what steps to take, the Commission may wish to consider whether existing EU laws are sufficient to curb any hypothetical negative effect on competition arising from minority shareholdings by institutional shareholders, whether in its antitrust, merger control, or other regimes.

Merger Control Rules

Under the EU Merger Regulation, an acquisition of minority shareholdings can trigger EU review if it gives the buyer "decisive influence" over the target. Minority shareholders may have control through veto rights on key decisions, such as the annual budget or business plan. Control can also arise when the other shareholdings are widely dispersed and smaller shareholders tend not to exercise their voting rights. The larger-but-minority shareholder may find that its stake gives it a *de facto* veto.

The Commission examined as recently as 2014 whether it should broaden its jurisdiction to noncontrolling stakes. In its final report, the Commission concluded that cases in which minority stakes can be problematic are relatively rare, and no legislative changes were proposed. Conversely, some national merger control rules have a lower concept of control (Germany and the United Kingdom are notable) and may trigger a filing and regulatory review.

Minority shareholdings nevertheless do not go unaddressed in European merger control.

In its substantive review of actual proposed mergers, the Commission does evaluate minority (including noncontrolling) shareholdings. In practice, the Commission sometimes has cleared mergers subject to divestment of minority stakes.

Antitrust Rules

Besides merger control, *ex post* antitrust enforcement can capture potential anticompetitive practices resulting from common minority shareholdings. Directors who sit on the boards of actual or potential competitors cannot act as a conduit for exchanges about competitively sensitive information between those competitors. The same principle applies to shareholders. While precedents are somewhat dated, they confirm that the EU rules concerning restrictive practices and agreements cover these types of situations.

Common Ownership in Practice

A major hurdle facing Commissioner Vestager's investigation is likely to be a lack of evidence that institutional funds have the means, or the desire, to influence the European companies in which they have made minority investments. This is especially true for passive funds that replicate market indices. The rules set forth above would not capture such passive investors. The Commissioner acknowledged in her speech "that there are certainly ways for these funds to make their voices heard. But we can't just assume they have the power to change minds. We need to look closely at what actually happens—whether they can really get companies to compete less hard."

On the behavioral side, compliance restricting information flows is well-established and familiar to professional investors and managers. Nevertheless, the recent announcement may lead to enforcement actions to investigate effective observance by investors with common shareholdings. The relatively dated precedents may be a reason for the Commission to take on a case and consider the issue and effective compliance afresh.

Conclusion

Existing EU and national competition law rules address the hypothesis that common ownership by institutional investors may restrict competition. It is questionable whether the Commission should devote material resources reacting to the U.S. study. The Commission recently concluded against an extension of the merger control review, and it has adequate enforcement powers to investigate anticompetitive practices, even covering the effect of common minority shareholdings if appropriate. Yet enforcement initiatives may follow.

THREE KEY TAKEAWAYS

1. The European Commission intends to assess whether private equity ownership of minority stakes in competing companies can restrict competition between those companies.
2. The Commission has not yet decided how to investigate, but the tools available include a sector inquiry, which could prove burdensome to companies expected to cooperate with information demands.
3. Existing EU competition rules likely suffice to address any concerns. Institutional investors should consider how best to join the debate and the Commission's early actions to shape the scope and impact of potential changes.

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