Interlocking Directorates in the Crosshairs of Regulation

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In recent years, interlocking directorates and common ownership have attracted increased attention from the academic community and enforcement agencies. To provide a framework for understanding interlocking directorates and common ownership, as well as the recent regulatory implications, the Joint Conduct Committee of the ABA Antitrust Law Section sponsored a webinar on June 12, 2024, titled "Interlocking Directorates in the Crosshairs of Regulation." The panel discussion was moderated by Lauren Hunt (Analysis Group) and included panelists Kelly Fayne (Latham & Watkins LLP), Brendan Ballou (author of *Plunder: Private Equity's Plan to Pillage America*), Edward B. Rock (NYU School of Law), and Albert Banal-Estanol (Universitat Pompeu Fabra).

This article summarizes the panel discussion, including the concepts of common ownership and interlocking directorates, their historical context, recent regulatory changes, the development of empirical studies, the role of private equity, and practical implications for corporate governance.

Concepts and Historical Context of Common Ownership and Interlocking Directorates

Ms. Fayne began by describing and differentiating between common ownership and interlocking directorates. Ms. Fayne noted that these are distinct phenomena: Common ownership refers to investors holding stakes in multiple competing companies, which can range from minimal shares to controlling interests; interlocking directorates, on the other hand, occur when individuals or agents serve on the boards of competing corporations. Common ownership can lead to interlocking directorates if investors, by virtue of their investment, appoint individuals to become board members of competing corporations or sit on these boards themselves. This situation may arise when certain individuals possess expertise and are appointed to multiple boards within the same industry, or when investors seek to deepen their involvement in the industry.

Mr. Ballou traced potential concerns about common ownership and interlocking directorates back to Louis Brandeis. In *Other People's Money and How the Bankers Use It*, Brandeis argued that the practice of interlocking directorates "tends to the suppression of competition and to violation of the Sherman law."[1] Mr. Ballou noted that Brandeis's ideas influenced the Federal Trade Commission Act of 1914, which includes the current statute that prohibits interlocking directorates.

Evolution of Enforcement and Empirical Evidence

Dr. Rock observed that systematic anticompetitive effects of interlocking directorates and common ownership have historically been difficult to prove, which, in his view, led to underenforcement of the law.

Dr. Rock cited recent scholarship that found that common ownership in the airline industry has led to an increase in ticket prices. 2 While alleged collusion in the airline industry has been the subject of investigation, Dr. Rock offered that anticompetitive effects from common ownership can also arise from management avoiding aggressive competition. He explained that, in principle, less aggressive competition is possible without explicit collusion or coordination with other firms.

Dr. Banal-Estanol noted that common ownership is prevalent in many industries and is becoming increasingly common in Europe. In his view, whether common ownership has anticompetitive or procompetitive effects requires further discussion. Dr. Banal-Estanol provided insights on the banking sector in Europe, where most banks are commonly owned, and explained that the interconnections between banks can provide benefits such as enhanced financial stability.

Private Equity's Role and Impact

Mr. Ballou explored the role of private equity in relation to interlocking directorates and common ownership. He noted that private equity firms' reliance on debt and fees, insulation from liability through portfolio companies, and short-term strategies might exacerbate anticompetitive risks. As an example, Mr. Ballou pointed to *Reading International, Inc., et al. v. Oaktree Capital Management, LLC, et al.* to illustrate the risk of private equity's involvement in interlocking directorates.

Mr. Ballou argued that a key issue to consider is whether the private equity firm has made a controlling or minority investment in the business. With a controlling investment, the entities involved are potentially considered one company, and thus potentially cannot form interlocking directorates between one another. A minority investment, however, may pose a risk of interlocking directorates, in his view.

To make private equity firms more productive and beneficial to the economy, Mr. Ballou emphasized the need to address flaws in their business model: reliance on debt and fees, insulation from liability, and short-term thinking. In his view, regulatory measures can incentivize private equity firms to reduce their dependence on debt, assume greater responsibility, and adopt a longer-term perspective.

Procompetitive Arguments for Common Ownership and Interlocking Directorates

Despite the potential regulatory risks, Ms. Fayne noted that there can be procompetitive arguments for interlocking directorates and common ownership. She explained that interlocking directorates can leverage individuals' expertise and create opportunities for increased funding. Ms. Fayne drew parallels to financial diversification and noted that investing in similar companies does not necessarily indicate an intent to coordinate. She called for a case-by-case analysis to understand the specific incentives. Ms. Fayne also highlighted the importance of rigorous, causal empirical research that considers various factors, including omitted variables and firm growth trajectories.

Corporate Governance and Practical Applications

Dr. Rock provided insights on the corporate governance implications of common ownership. He noted that the rise of institutional investors like BlackRock and Vanguard since the 1970s has led to a reconcentration of shareholders, which allows them to exert considerable influence over companies. In his view, this shift has prompted efforts to encourage these investors to actively oversee management and enhance governance. While some critics argue that common ownership depresses competition, Dr. Rock contended that the benefits of improved governance and shareholder engagement outweigh these antitrust concerns.

With respect to practical applications, Ms. Fayne noted that active enforcement on common ownership and interlocking directorates is not as common as other antitrust cases. She underscored the importance of awareness regarding these issues and advised that integrating antitrust compliance into board management, alongside other considerations such as conflicts of interest, is crucial.

Dr. Rock cautioned that in the world of common ownership, asset managers might inadvertently engage in conduct that raises antitrust concerns. Therefore, both asset managers and those working with them should strongly consider implementing appropriate antitrust compliance policies.

Endnotes

1 Brandeis, L. D. (1914). *Other People's Money and How the Bankers Use It*. Retrieved August 22, 2024 via Louis D. Brandeis School of Law Library.

2 Azar, J., Schmalz, M. C., & Tecu, I. (2018). Anticompetitive Effects of Common Ownership. *The Journal of Finance*, 73(4), 1513–1565.