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Jennifer G. Hill*

ABSTRACT

The common ownership debate has become one of the most contentious issues in corporate law today. This debate is a by-product of major changes to capital market ownership structure, which have triggered concerns about the rise of institutional investors, the growth of index investing, and the rapid concentration of ownership in major international financial markets.

The common ownership theory focuses on concerns about the incentives of large financial institutions holding widely diversified portfolios of shares in competing companies within a particular economic sector. Proponents of the common ownership theory argue that, even where institutional investors have relatively small ownership stakes, their collective holdings in competing companies produce anticompetitive effects. Other scholars, however, have challenged both the common ownership theory and its regulatory prescriptions. Although the common ownership theory began in the United States, it is now being discussed around the world.

This Article examines three conflicting narratives that emerge in this literature concerning institutional investors and the common ownership theory. The Article seeks to position these narratives within the context of the rising influence of institutional investors since the early 1990s and its relation to major international corporate governance developments. It analyzes aspects of the common ownership theory in light of these

* Jennifer Hill is the Bob Baxt AO Chair in Corporate and Commercial Law, Monash University Faculty of Law, Melbourne, Australia; Research Member of the European Corporate Governance Institute (ECGI). I would like to thank participants at the 2018 Global Corporate Governance Conference (GCGC) at Harvard Law School and participants at the NUS/Vanderbilt Law School Comparative Corporate Law & Governance: Asian and Global Perspectives 2019 conference in Singapore for helpful comments in relation to this paper. Thanks also go to Tim Bowley, Brent Fisse, Rob Nichols and Rebecca Wexler for valuable suggestions, and to Yesha Yadav for prompting my initial interest in the corporate governance implications of common ownership. Finally, I would like to thank Clare Hall, Cambridge University, where I was a Visiting Fellow while undertaking research for this article. Thanks also go to Mitheran Selvendran for excellent research assistance.
contemporary corporate governance developments and argues that drawing regulatory and policy conclusions from the current body of conflicting empirical findings on the effects of common ownership is premature.

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I. INTRODUCTION

One of the most contentious issues in corporate law today is the common ownership debate. This debate is a by-product of major changes to capital market structure over the last few decades. It reflects concern about the rise of institutional investors, the growth of index investing, and increasing ownership concentration in financial markets.1

"Common ownership" (which is sometimes used synonymously with the terms "horizontal shareholding" or "overlapping shareholding") describes the situation where large financial institutions with widely diversified portfolios own shares in competing companies within a particular economic sector. A number of scholars (described in this Article as “anti-common ownership scholars”) have argued that, even where these institutions have relatively small ownership stakes, their collective holdings in competing companies produce anticompetitive effects in a range of corporate governance contexts, such as mergers and acquisitions (M&A) and executive compensation. The basis for this claim is that, in such circumstances, the institutions are interested in the financial performance of their portfolios as a whole, rather than the performance of individual companies in that sector.

Although the common ownership debate began in the United States, it is now attracting attention around the world. For example, European intergovernmental and regulatory organizations have focused on the debate, which also has clear relevance to certain jurisdictions in the Asia-Pacific region. This is particularly true of Australia, given the distinctive role and large size of...
superannuation/pension funds in Australian capital markets\textsuperscript{10} and the
concentration of certain industries, such as the banking and finance
sector.\textsuperscript{11}

The aim of this Article is to contextualize the common ownership
theory within a broad range of international corporate governance
developments relating to institutional investment since the early
1990s. The structure of the Article is as follows. Part II discusses the
impact on legal scholarship of the common ownership theory, which
commenced in the field of financial economics. Part III examines three
possible narratives that exist in the literature relating to institutional
investors and common ownership. Part IV analyzes certain aspects of
the common ownership theory in the light of contemporary corporate
governance developments and debate, and Part V concludes the Article
and argues that drawing regulatory and policy conclusions from
current mixed empirical evidence is premature.

II. LAW'S DISCOVERY OF AN "ECONOMIC BLOCKBUSTER"

At the turn of the twenty-first century, a team of financial
economists, Professor Rafael La Porta \textit{et al.}, postulated that "law
matters" when it comes to the structure of capital markets.\textsuperscript{12} The
hypothesis claimed that jurisdictions with high levels of legal
protection for minority shareholders would develop deep liquid capital
markets like those in the United States and the United Kingdom.\textsuperscript{13}
The "law matters" hypothesis had significant policy implications for
regulation and law reform\textsuperscript{14} and proved highly influential in both
economics and law.\textsuperscript{15}

\textsuperscript{11} See Jennifer G. Hill, Why Did Australia Fare So Well in the Global Financial Crisis?, in THE REGULATORY AFTERMATH OF THE GLOBAL FINANCIAL CRISIS 203, 291–92 (Eilis Ferran et al., 2012).
\textsuperscript{12} See, e.g., Rafael La Porta et al., Law and Finance, 106 J. POL. ECON. 1113, 1116 (1998) (describing effects of different legal regimes on financial markets); Rafael La Porta et al., Corporate Ownership Around the World, 54 J. FINANCE 471, 472 (1999) (stating that countries with more legal protections provide more security for minority shareholders).
\textsuperscript{13} Id.
\textsuperscript{14} The "law matters" hypothesis also had strong normative overtones, viewing the legal protections offered by common law legal systems as superior to those found in civil law legal systems. See David A. Skeel Jnr, Corporate Anatomy Lessons, 113 YALE L.J. 1519, 1544–45 (2004).
Almost twenty years on, recent scholarship concerning common ownership provides a strong counterpoint to the “law matters” hypothesis in terms of its policy implications for capital market regulation. According to anti-common ownership scholars, the problem today is that fund flows to deep capital markets occur via a small number of increasingly powerful financial intermediaries with highly diversified portfolios.16

Like the “law matters” hypothesis, the common ownership theory originated in economic literature, but subsequently emerged in legal scholarship, where it has had a major impact. In a high profile 2016 Harvard Law Review article, Professor Einer Elhauge described the argument that common ownership has anticompetitive effects as a recently exposed “economic blockbuster.”17 Anti-common ownership scholars have referred to the rise of institutional investors as “[t]he great, but mostly unknown, antitrust story of our time,”18 and “a smoking gun.”19

There have been major changes to capital market structure over the last few decades, and these changes lie at the heart of the common ownership theory. Today, the dominant shareholders of public companies in many, but by no means all,20 jurisdictions are institutional intermediaries. The growth in financial intermediation in savings and investment decisions was foreseen from at least the 1970s by commentators, such as Peter Drucker21 and Professor Robert Clark.22 As anti-common ownership scholars have noted, however, financial intermediation investment channels are now highly concentrated.23 The alleged culprits behind the common ownership theory are major financial institutions, such as BlackRock, Vanguard,
and State Street Global Advisors.24 A frequently cited statistic is that the combined holdings of these institutions (the so-called Big Three)25 constitute the largest investment group in 88 percent of all S&P 500 firms,26 and this concentration is increasing.27

The common ownership theory is linked not only to institutional investors but also to a particular type of investment—index investing.28 There has been massive growth in index funds, including both index-based mutual funds and exchange-traded funds (ETFs),29 which has led some commentators to ask whether index funds are “eating the world.”30 Index investing, which relies upon wide stock performance diversification,31 has become the new default investment option for major financial institutions. According to BlackRock, for example, index investing is now a “cornerstone” of modern investment practice.32


25. See Lucian Bebchuk & Scott Hirst, Index Funds and the Future of Corporate Governance: Theory, Evidence and Policy, 119 COLUM. L. REV. 2029, 2033 (2019); Fichtner et al., supra note 24, at 298.

26. See Azar et al., supra note 3, at 1514 n.2.

27. It has been predicted that, by 2024, index funds will hold more than 50% of the US stock market. Jill Fisch et al., The New Titans of Wall Street: A Theoretical Framework for Passive Investors, 168 U. PA. L. REV. 17, 20 (2019).


Index funds, which have been described as “autopilot portfolios,” track stock indices rather than attempting to beat the market. They feature prominently in the literature discussing common ownership; however, it is important to note the implications of the common ownership theory are, in fact, far broader than this form of investing and also include actively managed funds.

In contrast to the “law matters” hypothesis, which regarded deep capital markets propelled by institutional investment as a desirable corporate governance outcome, anti-common ownership scholars view this form of diversified shareholding across concentrated product markets as deeply problematic. They claim that there is empirical evidence to show that common ownership results in reduced competition and higher consumer prices in certain sectors. The sectors targeted for academic scrutiny to date are the technology, airline, banking, and pharmaceutical industries. An influential economics paper by Professor José Azar et al., for example, claims that common ownership by the largest institutional investors in the US airline sector resulted in reduced competition and higher airline ticket prices for customers. Yet, according to Elhauge, the industries identified so far are merely the tip of the iceberg, and numerous other sectors are equally “plagued” by common ownership.

Anti-common ownership scholars warn that the growth of shareholder diversification could have a variety of dire consequences, potentially undermining the entire economy, with harmful effects on

33. Zweig, supra note 30.
34. See Gabriel Rauterberg & Andrew Verstein, Index Theory: The Law, Promise and Failure of Financial Indices, 30 YALE J. ON REG. 1, 1 (2013); Adriana Z. Robertson, Passive in Name Only: Delegated Management and “Index” Investing, 36 YALE J. ON REG. 795, 797 (2019) (for discussion of the nature of securities indices, which underpin index investing).
35. See BLACKROCK, supra note 28, at 1 (for a description of modern index investing practice).
36. Id.; Elhauge, New Evidence, supra note 2, at 27.
38. Id.
40. Azar et al., supra note 3, at 1513.
41. Elhauge, Horizontal Shareholding, supra note 6, at 1268; see also Elhauge, Growing Problem, supra note 17, at 1–2.
42. See, e.g., Bebchuk & Hirst, supra note 25, at 2133 (describing such warnings as “alarmism over common ownership”).
43. See Elhauge, Antitrust Law, supra note 5, at 1.
consumer welfare and equality, employment and wages, and society as a whole. The regulatory solutions suggested by some scholars to the supposed problems of the growth of institutional investors and common ownership are suitably Draconian. They include depriving index funds of their voting rights; restricting institutional investor share ownership to no more than one company in an oligarchy; and allowing institutional investors to hold shares in competing companies, only if those holdings do not exceed 1 percent, with forced divestiture in the case of noncompliance.

III. THREE POSSIBLE NARRATIVES CONCERNING COMMON OWNERSHIP

At least three possible narratives might be derived from increased portfolio diversification by institutional investors, which is frequently in the form of common ownership across the same industry. Scholarship concerning the phenomenon of common ownership often shifts between these narratives, without necessarily specifying which version it is addressing.

44. See, e.g., Partnoy, supra note 37 (stating that "[u]ltimately, the new theory of common ownership is a theory about inequality: To the extent that passive investing shifts costs to consumers, it makes the rich richer, and the poor poorer."); see also Elhauge, Growing Problem, supra note 17, at 10; Posner & Weyl, supra note 1.

45. Anti-common ownership literature also raises the issue of inequality, not only between shareholders and consumers, but also between shareholders and employees. See, e.g., Elhauge, Horizontal Shareholding, supra note 6, at 1292–93; Elhauge, New Evidence, supra note 2, at 15–16; Elhauge, Antitrust Law, supra note 5, at 11 (claiming that common ownership advantages shareholders, who are "disproportionately wealthy" and "depresses employment and wages in a way that further disproportionately harms the non-wealthy").

46. See, e.g., Azar et al., Ultimate Ownership, supra note 39, at 35 ("[u]nfortunately, the benefits to shareholders from diversification and good governance may come at a cost to consumers: efficient capital markets with perfect diversification and "good governance" imply deadweight losses in input and output markets") (an earlier version of this article argued that diversification and good governance harmed "society at large"); see also Dorothy S. Lund, The Case Against Passive Shareholder Voting, 43 J. Corp. L. 493, 494 (2018) (arguing that the likely result of index investing is serious economic harm); Elhauge, New Evidence, supra note 2, at 26 (arguing that "enormous harm" of this kind is already occurring as a result of common ownership).


48. Lund, supra note 46, at 497.


50. See generally Lund, supra note 46. At times, Professor Lund argues that “passive” index investors lack the financial incentive to monitor their portfolio companies to ensure that they are managed effectively, which appears to be a variant of Version 1 below. Id. at 495, 511, 512. She also argues, however, that these investors will “increasingly influence and even control the outcome of shareholder interventions”, which suggests either Version 2 or Version 3 below. Id. at 493.
Version 1, which might be labelled “the lazy investor narrative,” focuses on the general incentives and behavior of fund managers. The argument here is that portfolio diversification, particularly across companies in the same economic sector, may result in perverse or inadequate incentives for institutional investors to engage in strong monitoring. This narrative suggests that, particularly from a cost–benefit analysis, it may not make sense for fund managers to adopt a private investor/owner–like stance toward individual companies in a widely diversified portfolio and that rational apathy will therefore prevail.

This narrative assumes that lack of interest by institutional investors in the performance of individual portfolio firms will be harmful to the company’s performance. It suggests that lazy investors inevitably breed lazy managers, whose desire to enjoy “the quiet life” will override their responsibilities to the company and its shareholders. In this narrative, lack of attention by institutional investors enables the portfolio firm’s managers to call the shots in favor of their own preferences and self-interest.

This was a familiar part of the so-called passivity story of the 1990s. The underlying presumption in corporate governance literature during this period was that monitoring by institutional investors is a positive feature of corporate governance, and nonparticipation by such investors is a corporate governance problem in need of a solution.


54. See, e.g., Azar et al., supra note 3 (suggesting that failure by institutional investors to demand or provide incentives for greater competition between portfolio firms may allow managers of those firms “to enjoy the ‘quiet life’”); Azar et al., Ultimate Ownership, supra note 39, at 5.

55. See Marianne Bertrand & Sendhil Mullainathan, Enjoying the Quiet Life? Corporate Governance and Managerial Preferences, 111 J. POL. ECON. 1043, 1043 (2003); Elhauge, Growing Problem, supra note 17, at 5 (stating that “because competing vigorously is hard work for managers, they are less likely to do it unless their shareholders are actively pressuring them to compete”).


find ways to overcome the legal and economic barriers to greater institutional investor engagement in corporate governance. 58

Recent articles, by Professor Dorothy Lund and Professors Lucian Bebchuk and Scott Hirst, represent modern incarnations of this narrative. 59 Lund, for example, has argued within this paradigm that index funds are quintessentially passive and ignorant investors, with inadequate incentives to monitor management. 60 Bebchuk and Hirst are also concerned that index fund managers have incentives to underinvest in stewardship and to be overly deferential to the managers of portfolio companies. 61

Yet, although the articles by these scholars reveal similar concerns, their regulatory prescriptions are quite different. Lund effectively adopts a punitive approach, arguing that index funds, as innately lazy investors, should therefore be deprived of their voting rights. 62 Bebchuk and Hirst, on the other hand, are more sanguine, suggesting reforms to counteract current incentives that nudge index fund managers toward passivity. 63 Their goal is to make index fund voting better informed and meaningful. 64

Bebchuk and Hirst’s approach is consistent with the policy goals in many parts of the world, where the aim is to increase, not decrease, corporate governance engagement by institutional investors, including index funds. 65 Lund’s proposal, however, directly conflicts with those policy goals. 66 Furthermore, discrimination of the kind advocated by Lund could be unlawful in jurisdictions where a one-vote-per-share policy prevails. 67 It is interesting to note, for example, that, in Australia, an attempt to alter the corporate constitution of a company to disenfranchise institutional investors was struck down by the court.
on the basis that such inherent discrimination between different shareholder groups constituted fraud on the minority.\(^8\)

Versions 2 and 3 of the possible common ownership narratives differ significantly from Version 1. Whereas Version 1 raises concerns about lack of engagement by institutional investors, Version 2 suggests that they are too involved in corporate governance. Also, whereas Version 1 focuses on the danger of uncontrolled power by corporate managers, Versions 2 and 3 are underpinned by concern about the behavior and/or power of institutional investors themselves.

According to Version 2, which might be described as "the anticompetitive pressure model," where common ownership occurs across the same economic sector, institutional investors will have skewed incentives, leading them to abuse their ownership rights by pressuring managers of investee firms to act in an anticompetitive or collusive fashion. This narrative would seem to suggest that common ownership involves situations where institutional investors pressure managers of investee companies to engage in anticompetitive conduct.\(^9\)

This interpretation of Version 2 appears to require active conduct by institutional investors to subvert competition between portfolio companies in the same sector. Such an interpretation accords with Professor Richard Buxbaum's suggestion almost twenty years ago that "a totally passive investor . . . may be easier to accept than an active one."\(^0\)

At first sight, this interpretation of Version 2 would seem to exclude index funds on the basis that they are passive investors only. Nonetheless, there is a broader interpretation of Version 2, which is capable of including index funds, by challenging the accuracy of their depiction as "passive investors."\(^1\) It has been argued, for example, that, although index investors cannot vote on, or influence, the

\(^{68}\) See Australian Fixed Trusts Ltd. v Clyde Indus. Ltd. (1959) 59 SR (NSW) 33 (Austl.).

\(^{69}\) See Elhauge, Horizontal Shareholding, supra note 6, at 1269 (arguing that "institutional investors usually . . . communicate with and actively seek to influence" their portfolio companies, although Elhauge, relying on Version 3 of the common ownership narrative, denies that this is a precondition to anticompetitive outcomes). Note also that some anti-common ownership theorists rely on negative, rather than positive, pressure by institutional investors—interpreting failure to pressure management to compete aggressively as having an equivalent anticompetitive effect. See Azar et al., Ultimate Ownership, supra note 39, at 5–6; Elhauge, New Evidence, supra note 2, at 28–29 (stating that "reduction in pressure itself will likely have anti-competitive effects").


competitive strategies of their portfolio firms, they, nonetheless, behave as active investors when they exercise rights attached to their shares with respect to governance matters (such as nomination of board members, executive compensation) and engage in dialogue with management.

Indeed, large asset managers themselves reject the notion that they are “passive.” Vanguard has stated, for example, “[w]e believe that our active engagement demonstrates that passive investors don’t need to be passive owners.” Similarly, BlackRock has criticized the supposed dichotomy between active and passive shareholders as superficial, suggesting that most traditional asset managers adopt an approach midway between these two outer points. Also, the majority of index funds are not stand-alone funds. Rather, they are part of investment fund families, which will include active funds, and this may provide index funds with incentives to improve the corporate governance of a given company, in circumstances where that would improve performance of the fund family as a whole. Moreover, even when index funds track a particular index, fund managers will have some discretion in terms of the relative weighting they give to stock in that index.

Institutional investors have also stressed that, since they are effectively locked into their investment for the long term, they need to engage with the managers of the companies in which they invest.

72. See, e.g., Azar et al., supra note 3, at 1557 (stating “[w]e do not mean to suggest here that shareholders vote directly on competitive strategies”); see also BLACKROCK, supra note 28, at 8; Rock & Rubinfeld, supra note 47, at 9.

73. See, e.g., Azar et al., supra note 3 at 1553.


77. Id.


Under Version 1 of the common ownership narrative, increased engagement in corporate governance by large institutional investors reflects good corporate governance.\(^8^0\) Under the more expansive interpretation of Version 2, it is dangerous, in that it potentially involves transmission of anticompetitive incentives to portfolio firms.\(^8^1\)

Version 3 of the common ownership narrative does a significant pivot in terms of perspective. Unlike Version 2, which examines the incentives and behavior of institutional investors, Version 3 instead focuses solely on the incentives and behavior of corporate managers of the investee firms, albeit under the shadow of institutional investor power. In so doing, Version 3 eliminates the need to show any misuse of share ownership rights by institutional investors; it is immaterial whether investors are active or passive. Under Version 3, which might be called “the mindreading model,” it is sufficient that the corporate managers of the portfolio firm are aware that common ownership exists in their sector, on the basis that this awareness allows them to discern, and follow, the presumed anticompetitive preferences of large diversified investors.\(^8^2\) Adopting the mindreading model, some anti-common ownership scholars have predicted that managers who correctly divine institutional investor preferences by “either conscious calculation, intuition, or pure luck”\(^8^3\) will tend to be selected to run the firm.\(^8^4\) In evolutionary terms, this would appear to be a variant of natural selection.\(^8^5\)

Version 3 of the common ownership narrative goes substantially further than Version 2. Under Version 3, the allegedly anticompetitive incentives are “purely structural,”\(^8^6\) deriving from the mere fact of common ownership. Indeed, under this version of the common ownership narrative, it is irrelevant that: all the financial interests are merely minority shareholdings;\(^8^7\) the institutional investors have not themselves engaged in any conduct to achieve anticompetitive ends;\(^8^8\) there has been no attempt by institutional investors to communicate

\(^8^0\) See Bebchuk & Hirst, supra note 25, at 2034.

\(^8^1\) See Azar et al., supra note 3 at 1560; Azar et al., Ultimate Ownership, supra note 39, at 5.

\(^8^2\) See, e.g., Elhauge, Horizontal Shareholding, supra note 6, at 1270 (suggesting active communication is not necessary for common ownership to have anticompetitive effects).

\(^8^3\) Azar et al., Ultimate Ownership, supra note 39, at 5.

\(^8^4\) Id.

\(^8^5\) See, e.g., Emily Osterloff, What is Natural Selection?, NAT. HISTORY MUSEUM (Mar. 18, 2019), https://www.nhm.ac.uk/discover/what-is-natural-selection.html [https://perma.cc/HB7N-WDJA] (archived Feb. 4, 2020) (describing “natural selection” as an evolutionary mechanism by which “[o]rganisms that are more adapted to their environment are more likely to survive . . . ”).

\(^8^6\) Elhauge, Horizontal Shareholding, supra note 6, at 1270; see also Elhauge, Growing Problem, supra note 17, at 2 (declaring that the problem of horizontal shareholding is structural).

\(^8^7\) See generally Azar et al., supra note 3.

\(^8^8\) Elhauge, Horizontal Shareholding, supra note 6, at 1270.
with, or influence, managers of the portfolio company;\textsuperscript{89} and there is no coordination or collusion between managers of competing companies.\textsuperscript{90}

According to Elhauge, who adopts Version 3 of the common ownership narrative, where institutional investors own shares in competing companies, those investors are liable under US antitrust law if their pattern of ownership lessens competition, regardless of whether they have undertaken any positive actions to contribute to such an outcome.\textsuperscript{91} This is a startling proposition. It is reminiscent of Justice Louis Brandeis's comment more than a hundred years ago that "[t]here is no such thing . . . as an innocent stockholder."\textsuperscript{92}

IV. THE THEORY OF COMMON OWNERSHIP FROM A CORPORATE GOVERNANCE PERSPECTIVE

The common ownership theory subverts many fundamental tenets of contemporary corporate governance concerning the desirability of increased shareholder engagement. Version 3 of the common ownership narrative posits that mere ownership of shares by institutional investors across concentrated industries can ipso facto breach competition laws. This is a sufficiently disquieting proposition as to warrant close scrutiny of the common ownership theory from a corporate governance perspective. There are a number of points that

\textsuperscript{89}. See Elhauge, \textit{Antitrust Law}, supra note 5, at 9 (arguing that shareholder communications become irrelevant in lessening competition when incentives in executive compensation achieve that aim); Elhauge, New Evidence, \textit{supra} note 2, at 2 (horizontal shareholding/common ownership does not require communication between shareholders and managers); see also Elhauge, \textit{Growing Problem}, \textit{supra} note 17, at 2 (arguing that anticompetitive effects of horizontal shareholding do not depend on communication between managers); Elhauge, \textit{Horizontal Shareholding}, \textit{supra} note 6, at 1269 (stating anticompetitive effect does not require communication between managers and shareholders). Elhauge notes, however, that communication by institutional investors to managers, in fact, often occurs. \textit{Id.} at 1269–70.

\textsuperscript{90}. See \textit{Azar et al., Ultimate Ownership}, \textit{supra} note 39, at 4–5 ("the fact that concentrated ownership is related to higher prices for banking products need not be driven by collusion, i.e., coordinated price-setting between banks."); Elhauge, \textit{Antitrust Law}, \textit{supra} note 5, at 1–2 (stating that horizontal shareholding/common ownership does not require coordination between managers of different companies); Elhauge, \textit{Horizontal Shareholding}, \textit{supra} note 6, at 1269 (stating that horizontal shareholding does not depend on managers coordinating with each other); see also Elhauge, \textit{Growing Problem}, \textit{supra} note 17, at 2 (stating anticompetitive effect does not depend on coordination between managers); Elhauge, New Evidence, \textit{supra} note 2, at 2 (horizontal shareholding/common ownership does not require communication between managers of different companies); Posner & Weyl, \textit{supra} note 1 (arguing that there is no requirement for managers to conspire with each other ).

\textsuperscript{91}. See generally Elhauge, \textit{Horizontal Shareholding}, \textit{supra} note 6 (arguing that stocks which create anticompetitive common ownership are illegal under current antitrust law).

can be made about the common ownership theory, which suggest possible weaknesses in its conclusions.

A. Common Ownership Is a Controversial and Broad-Brush Theory

In spite of its early academic impact, it is worth remembering that the common ownership theory is just that—a theory—and that theorizing about the possible anticompetitive effects of common ownership on managerial incentives does not prove that those effects occur in practice. Nor does it prove that any anticompetitive behavior which does exist is caused by common ownership. A recent empirical study by Professor Erik Gilje, et al., for example, provides data to assess the extent to which the theory represents reality, and its findings suggest that in many instances, the empirical evidence does not conform to theory in relation to common ownership.

Not only is the common ownership argument just a theory, it is also a very broad-brush theory, which contains several puzzling elements. For example, one curious aspect of the mindreading model, Version 3 of the common ownership narrative, is why corporate managers would, without any pressure or direction, act in the presumed interests of institutional investors with diversified portfolios. Elhauge suggests that corporate managers might behave in this way for a litany of possible reasons—"out of a sense of fiduciary duty or gratitude, to gain support in future elections, to enhance future job prospects, because executive compensation methods align with shareholder interests, or so their shareholders will fend off takeover threats." Also, discerning institutional investors' presumed preferences under Version 3 will be no easy task. Those interests and preferences are heterogeneous and constantly in flux, rendering the assessment that corporate managers are required to make difficult and prone to miscalculation.

Such far-reaching suppositions about the means by which anticompetitive incentives might be transmitted from institutional investors to corporate managers suggest the need for further empirical

93. See BLACKROCK, supra note 28, at 2, 6–7, 15 (arguing that some of the assumptions made in existing literature examining economics theory are based on misconceptions of reality).

94. Id.


96. Id.

97. Elhauge, Horizontal Shareholding, supra note 6, at 1270.

98. See Rock & Rubinfeld, supra note 47, at 4–5 (demonstrating the heterogeneity of the holdings of the largest shareholders).
research, like the Gilje et al. study, to bring greater clarity to the investigation of whether corporate managers actually behave in this way and, if they do, why this occurs and under what circumstances. A growing number of studies have challenged the empirical underpinnings of the common ownership theory, and the mechanisms, including executive remuneration, which have been suggested might provide the necessary conduit for transmission of anticompetitive incentives to corporate management.

B. The Common Ownership Theory Includes Some Questionable Underlying Presumptions

The common ownership argument also includes several questionable presumptions in reaching its conclusion that corporate managers will behave in an anticompetitive way. As already noted, Version 2 of the common ownership narrative surmises that institutional investors will exert anticompetitive pressure on corporate managers of investee firms. Version 3 goes further, by suggesting that institutional investors, including index funds, are so powerful that the corporate managers will do their presumed bidding, even in the absence of such pressure. Shareholder power and participation in corporate governance in the United States has undoubtedly increased in recent years, but are institutional investors as formidable as anti-common ownership scholars suggest?

Versions 2 and 3 of the common ownership narrative contradict the traditional image of the institutional investor as passive and a

99. Gilje et al., supra note 95 (casting doubt on the theory that common ownership significantly affects managerial incentives).


103. See generally Hill, Trajectory, supra note 65 (discussing evolving shareholder governance rights acquired by private ordering).

104. See Black, Shareholder Passivity, supra note 56, at 520, 567–70 (arguing recent developments in institutional stock ownership and voting behavior make the passivity story obsolete).
"paper colossus," since they presume high levels of institutional investor influence. In fact, US shareholders have far fewer statutorily guaranteed corporate governance participatory rights than shareholders in other common law jurisdictions, including the United Kingdom and Australia. Also, recent studies highlight the fact that institutional investors direct relatively limited resources towards corporate monitoring. These studies show that investment managers of mutual funds, both indexed and actively managed, have incentives to spend negligible amounts on stewardship, and to side excessively with managers of corporations. These studies suggest that, rather than corporate managers bending to institutional investors' pressure (Version 2) or presumed preferences (Version 3), institutional investors, in fact, generally follow the lead of the corporate managers. Also, even when investors do flex their muscles by, for example, seeking stronger governance rights, management often responds by engaging in "private ordering combat," to try to modify or dilute the rights sought by shareholders.

106. See Jennifer G. Hill, Subverting Shareholder Rights: Lessons from News Corp.'s Migration to Delaware, 63 VAND. L. REV. 1 (2010) (explaining why News Corp. moved from Australia to Delaware); Hill, Trajectory, supra note 65, at 514 (including majority voting, convening shareholder meetings, and nominating and removing directors).
107. See Lucian A. Bebchuk et al., The Agency Problems of Institutional Investors, 31 J. ECON. PERSP. 89 (2017) (arguing that agency costs disincentivize fully investing in stewardship of company); Bebchuk & Hirst, supra note 25, at 2050 (arguing that index fund managers have strong incentives to underinvest in stewardship); see also Strampelli, supra note 65 (arguing that policy makers need to encourage index fund managers and institutional investors to play a greater oversight role).
108. See Bebchuk et al., supra note 107, at 100 (citing several companies that spent negligible amounts on stewardship).
109. See id. at 96 (arguing agency costs disincentivize proxy fights with managers); Bebchuk & Hirst, supra note 25 (arguing that index fund managers have strong incentives to side with corporate managers); see also Lund, supra note 46, at 523–26 (discussing the rise of passive investing).
110. This conclusion accords with the findings of the Gilje, Gormley and Levit study on the impact of index investing on managerial incentives. See Gilje et al., supra note 95 (arguing that some investors do not pay much attention to the actions of managers); see also Bebchuk & Hirst, supra note 25; Lund supra note 46 at 512–13.
111. Hill, Trajectory, supra note 65, at 524–40.
112. See id. (demonstrating that managers changed the interpretation of regulations and amended bylaws to weaken shareholder mechanisms of managerial control).
C. Recognition of the Link Between Concentrated Ownership and Antitrust Law Is Not New

The references to common ownership by institutional investors as a "blockbuster" discovery, and its description as the "great, but mostly unknown, antitrust story of our time" suggest that the link between the growing concentration of share ownership and antitrust issues has only recently been uncovered. This is not, in fact, the case. Corporate governance literature from the early 1990s onwards focused on the implications of concentration of share ownership associated with the rise of institutional investment. Buxbaum, for example, highlighted the fact that a broadening of portfolio distribution was the inevitable consequence of the absolute growth of institutional investment pools, while Professor Bernard Black sought ways of ensuring increased "institutional voice," in accordance with Version 1 of the common ownership narrative discussed above.

These scholars also explicitly considered the growth in concentrated ownership and portfolio diversification from a competition law perspective. Yet, they concluded that antitrust law constituted a very weak constraint on institutional investors. Although Buxbaum acknowledged the theoretical possibility that institutional investors could contravene antitrust laws, the potential scenarios in which he thought this might occur went well beyond mere common ownership, as envisaged under Version 3. Rather, Buxbaum's examples involved coordinated forms of institutional investor activism, such as a targeted collective boycott against a particular firm. Black also considered this issue, and, like Buxbaum, viewed the risk at that time to be "entirely theoretical," and subject to countervailing factors that reduced the likelihood of antitrust violations. The approach of Buxbaum and Black is consistent with a narrow reading of Version 2 of the common

113. See Elhuge, Horizontal Shareholding, supra note 6, at 1283 (arguing that antitrust enforcement has historically been lacking because the link between horizontal shareholding and anticompetition issues has only recently been recognized).
114. Posner et al., supra note 1, at A29.
115. See also Partnoy, supra note 37 (tracing the origins of the common ownership argument back to a 1984 paper by Julio Rotemberg).
116. Buxbaum, supra note 70, at 3.
118. See Black, Agents Watching Agents, supra note 57; Buxbaum, supra note 70.
119. Buxbaum, supra note 70, at 25.
120. Id.
121. Id.
122. Id.
124. Id.; see also Black, Shareholder Passivity, supra note 56, at 558–60 (describing several regulatory obstacles to antitrust violations).
ownership narrative, which would require actual misuse of ownership rights by institutional investors to achieve anticompetitive ends.\footnote{125}

Professors Rock and Rubinfeld have addressed this issue more recently and come to a similar conclusion.\footnote{126} Although acknowledging that common ownership by institutional investors could in certain circumstances have anticompetitive effects, Rock and Rubinfeld find no persuasive evidence that this state of affairs currently exists.\footnote{127} BlackRock has similarly criticized the common ownership theory as based on "fragile evidence" in this regard.\footnote{128}

D. Common Ownership Is a US-Centric and Industry-Specific Debate

Although the common ownership debate is now spreading around the world, its origins are inherently US-centric in their focus on particular American industries. Nonetheless, the market for capital is now global and there are developments, both in the United States and elsewhere in the world, which potentially affect that investment ecosystem and the common ownership debate. For example, in recent years there has been a striking reduction in the number of public companies in the United States,\footnote{129} which has increased the importance of global investment opportunities for US institutional investors.

American companies are not always competing with each other. Indeed, they are not always competing with companies that have the same governance structures, as is shown by the rise of Chinese State-Owned Enterprises (SOEs).\footnote{130} Whereas some of the industry clusters

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\footnote{125. In the Australian competition law context, it is interesting to note that amendments were introduced in November 2017, which prohibit "a concerted practice that has the purpose, or has or is likely to have the effect, of substantially lessening competition"; Competition and Consumer Act § 45 (2010); see generally Nichols & Kayis, supra note 10.}

\footnote{126. See Rock & Rubinfeld, supra note 47 (suggesting that, in proposing guidelines to prevent anticompetitive behavior, it is still important to protect investors' involvement in corporate governance).}

\footnote{127. Id. Rock and Rubinfeld dismiss the common ownership argument, by stating, "[w]e have considered the antitrust attack on widely diversified institutional investor ownership, and found it lacking." Id. at 37.}

\footnote{128. BLACKROCK, supra note 28, at 2, 6–7; see also Hemphill & Kahan, supra note 102, at 46 (arguing that there is a "strong theoretical basis" for the assumptions that underlie the common ownership theory).}

\footnote{129. See generally IHA M. MILLSTEIN CENTER FOR GLOBAL MARKETS AND CORPORATE OWNERSHIP, PRIVATE OWNERSHIP AT A PUBLIC CROSSROADS: STUDYING THE RAPIDLY EVOLVING WORLD OF CORPORATE OWNERSHIP (2019) (arguing that ownership and control of companies has shifted from individuals in public markets to individuals in private markets).}

\footnote{130. See Li-Wen Lin & Curtis J. Milhaupt, We Are the (National) Champions: Understanding the Mechanisms of State Capitalism in China, 65 STAN. L. REV. 697 (2013) (explaining the importance of SOEs for China's model of state capitalism). High levels of state control are also found in a number of other jurisdictions, such as Singapore. See, e.g., Luh Luh Lan & Umakanth Varottil, Shareholder Empowerment in
considered in the common ownership literature, such as the banking and the airline industries, may be US oligopolies, others, such as technology and pharmaceutical sectors, are now global markets. Even in concentrated industries, spillover effects in other industries and other markets, in which highly diversified shareholders are invested, will necessarily complicate any assessment of investor incentives. 131

From a global investment perspective, it is interesting to examine The Norwegian Government Pension Fund Global (the Norwegian oil fund), 132 which is the world's largest sovereign wealth fund, with over $1 trillion in assets. 133 In 2015, the fund announced that it was moving from passive investment to adopting an active owner stance. 134 It now has stakes in over nine thousand companies in seventy three countries, and owns an average of 1.4 percent of every company listed on any stock market around the world. 135 The Norwegian oil fund's record breaking 2017 annual return of $131 billion 136 was largely attributable to its broad investment strategy, coupled with the strong performance of technology stocks in its global portfolio, including Apple and Microsoft in the United States and Tencent in China. 137

Controlled Companies: The Case of Singapore, in RESEARCH HANDBOOK OF SHAREHOLDER POWER, supra note 20, at 572.


135. NORGES BANK INVESTMENT MANAGEMENT, GOVERNMENT PENSION FUND GLOBAL 28 (2018) [hereinafter NORGES BANK PENSION FUND]; About Us, supra note 132.


As noted, the largest US institutional investors are also increasingly involved in international markets. Although they tend to have investments in far fewer companies than the Norwegian oil fund, their investment levels are, on average, higher. For example, it is estimated that BlackRock owns at least 5 percent of over 2,600 companies worldwide and Vanguard owns around the same level of 1,800 companies worldwide.138

The investment strategy of the Norwegian oil fund is based on the objective of “maximising return with moderate risk.”139 The kinds of restrictions that are suggested by anti-common ownership scholars would seriously undermine the investment strategies of US institutional investors which, like the Norwegian oil fund, seek to use broad portfolio diversification as a risk management tool.

E. Common Ownership in Megacompanies

Another problematic aspect of the common ownership hypothesis is its focus on institutional investors, rather than on the rise in market power of the investee firms themselves. If these firms have indeed engaged in anticompetitive behavior, it might be thought that they would be more obvious targets for competition law than their shareholders.140 Yet, by targeting investment patterns, the common ownership literature obscures the fact that the firms in some sectors, such as the technology sector, have themselves become “powerful megacompanies.”141 This is reflected in Apple’s 2018 market valuation of $1 trillion,142 and in Senator Elizabeth Warren’s proposal to break up companies, such as Amazon, Facebook, and Google.143
Several recent studies have shown a dramatic increase in the size and concentration levels of companies in some industries, including in the banking sector and airlines sector, which feature so prominently in the common ownership debate.\textsuperscript{144} For some economists, it is the corporate consolidation and concentration of power in a small number of megacompanies, rather than their capital structure, which has created problems relating to wage inequality\textsuperscript{145} and consumer welfare.\textsuperscript{146} This suggests the possibility that the common ownership theory may reflect correlation, rather than causation.\textsuperscript{147}

The regulatory implications of this approach are that the law should target the companies that engage in anticompetitive conduct, rather than targeting institutional investors, by restricting their ability to own shares in competing companies.\textsuperscript{148} A recent report of the Australian Government Productivity Commission adopts this approach in relation to Australia’s extremely concentrated financial sector.\textsuperscript{149} Acknowledging that these huge financial institutions “have the ability to exercise market power over their competitors and consumers,”\textsuperscript{150} the report adopts a targeted approach to

\textsuperscript{144} See, e.g., Gustavo Grullon et al., \textit{Are US Industries Becoming More Concentrated?}, 23 REV. FIN. 697 (2019) (finding that over seventy-five percent of companies saw an increase in their concentration); see also Kathleen Kahle & René M. Stulz, \textit{The Shrinking Number of Public Corporations in the US}, LONDON SCH. OF ECON. & POL. SCI. US CENTRE (Oct. 21, 2017), http://bit.ly/2yWc6El [https://perma.cc/9YXQ-N7SG] (archived Feb. 4, 2020) (noting the massive increase in market concentration in the United States between 1975 and 2015, in which “the winners have done well”); IRA M. MILLSTEIN CENTER, supra note 129 (highlighting the dramatic decline in the number of public companies).


\textsuperscript{146} See Grullon et al., supra note 144 (explaining that firms enjoy higher profit margins, but it is unclear whether consumers benefit from higher quality products).

\textsuperscript{147} See BLACKROCK, supra note 28, at 2 (arguing that the common ownership research in the economics literature does not provide a “plausible causal explanation of how common ownership can lead to higher prices”); see also id. at 6–7, 15.

\textsuperscript{148} See, e.g., Krueger & Ashenfelter, supra note 145, at 2–3.

\textsuperscript{149} See AUSTRALIAN GOVERNMENT PRODUCTIVITY COMMISSION, \textit{COMPETITION IN THE AUSTRALIAN FINANCIAL SYSTEM: PRODUCTIVITY COMMISSION INQUIRY REPORT: OVERVIEW & RECOMMENDATIONS}, No. 89 (2018) (recommending fostering and protecting competition to improve consumer outcomes, enhance the productivity and international competitiveness of the financial system and the broader economy, and support ongoing innovation).

\textsuperscript{150} Id. at 2.
anticompetitive conduct by such firms that may exploit their customers.\textsuperscript{151}

In an era of megacompanies, the presence of large powerful institutional investors as a counterweight is not necessarily an undesirable corporate governance development.

F. Investee Firm Managers and Their Fiduciary Duties

The common ownership theory not only diverts attention from potentially anticompetitive conduct of portfolio companies themselves, but it also diverts attention from the conduct of directors and officers of those firms.\textsuperscript{152} As Commissioner Hayne stressed in Australia’s recent high profile Banking Royal Commission,\textsuperscript{153} directors and officers are required to exercise their duties for the benefit of their corporation, which involves more than considering merely financial returns to shareholders.\textsuperscript{154} Furthermore, Commissioner Hayne disputed the idea that the interests of shareholders and customers are opposed,\textsuperscript{155} noting that the interests of both groups will generally converge when directors and officers act in the long-term financial best interests of the corporation.\textsuperscript{156}

The Banking Royal Commission’s Final Report took the view that, in addition to the banks themselves, their boards and senior managers bore responsibility for misconduct, which enhanced corporate profits by exploiting customers.\textsuperscript{157} This raises the possibility that corporate managers could themselves be liable for breach of either the duty of care or the duty to act in good faith in the best interests of the company as a whole. Although liability for breach of the duty of care is unlikely

\textsuperscript{151}. See James Frost, Productivity Commission’s Final Report Lashes Banks for Exploiting Customers, AUSTL. FIN. REV. (Aug. 3, 2018), https://www.afr.com/companies/financial-services/productivity-commissions-final-report-lashes-banks-for-exploiting-customers-20180803-h13in7 [https://perma.cc/YNW5-Z6WJ] (archived Feb. 4, 2020) (recommending appointing a Principal Integrity Officer to oversee banks); AUSTRALIAN GOVERNMENT PRODUCTIVITY COMMISSION, supra note 149, at 2, 16–17, 24–25, 45, 53 (explaining that targeted approach includes the Australian Competition and Consumer Commission and mandating a Principal Integrity Officer for all banks). As the report notes, an extremely profitable financial system is “not necessarily a bad thing,” provided it is “workably competitive.” \textit{Id.} at 12.

\textsuperscript{152}. See Daniel P. O’Brien & Keith Waehrer, The Competitive Effects of Common Ownership: We Know Less Than We Think, 81 ANTITRUST L.J. 729, 765–66 (discussing the role of directors’ and officers’ fiduciary duties in the context of the common ownership debate); AUSTRALIAN GOVERNMENT PRODUCTIVITY COMMISSION, supra note 149, at 2, 24–25, 45 (recommending Principal Integrity Officers in parent financial entities).

\textsuperscript{153}. ROYAL COMMISSION INTO MISCONDUCT IN THE BANKING, SUPERANNUATION AND FINANCIAL SERVICES INDUSTRY, COMMONWEALTH OF AUSTRL. (2019).

\textsuperscript{154}. \textit{Id.} at 402.

\textsuperscript{155}. \textit{Id.} at 403.

\textsuperscript{156}. \textit{Id.}

\textsuperscript{157}. \textit{Id.} at 4.
under US corporate law, due to the capacious protection offered by the business judgment rule and exculpatory clauses, directors and officers face a much greater risk of liability under Australian law. It is, therefore, arguable that if, under Version 2 or Version 3 of the common ownership narrative, directors and managers of investee firms engaged in anticompetitive conduct (based on the actual or presumed preferences of a segment of the body of shareholders), those directors and officers would breach their statutory duties to the company under Australian law.

G. Institutional Investors and the Growing Importance of ESG

The common ownership theory is focused almost exclusively on the goal of profit maximization. It arguably ignores one of the most important developments in current international corporate governance, namely the growing importance of environmental, social, and governance (ESG) factors. Large institutional investors increasingly view a diverse range of ESG factors, such as climate

158. See In re Caremark Int'l Inc. Derivative Litig., 698 A.2d 959, 971 (Del. Ch., 1996) (limiting director liability for oversight failure). But see Marchand v. Barnhill, 212 A.3d 805 (Del. 2019) (plaintiffs successfully pleaded that the directors were not protected under the Caremark doctrine).

159. This is due to the availability of “stepping stone” liability under Australian law, whereby directors and officers may be personally liable for failure to prevent contraventions of the law by their corporation. See, e.g., Abe Herzberg & Helen Anderson, Stepping Stones—From Corporate Fault to Directors’ Personal Civil Liability, 40 FED. L. REV. 181 (2012) (arguing that by exposing their company to legal or reputational damage, directors violate their statutory duty of care); Tim Bednall & Pamela Hanrahan, Officers’ Liability for Mandatory Corporate Disclosure: Two Paths, Two Destinations?, 31 COMPANY & SEC. L.J. 474 (2013); Alice Zhou, A Step Too Far? Rethinking the Stepping Stone Approach to Officers’ Liability, 47 FED. L. REV. 151 (2019).

160. These statutory duties are primarily enforceable by the Australian securities regulator, ASIC. For a comparison of enforcement of directors’ duties under US and Australian law, see Renée Jones & Michelle Welsh, Toward a Public Enforcement Model for Directors’ Duty of Oversight, 45 VAND. J. TRANSNAT’L L. 343 (2012).

161. See generally Jennifer G. Hill, Corporations, Directors’ Duties and the Public/Private Divide, in FIRM GOVERNANCE: THE ANATOMY OF FIDUCIARY OBLIGATIONS IN BUSINESS (Arthur Laby & Jacob Russell eds., 2020) (arguing that corporate financial performance is only one of multiple problems in corporate law and that an equally important problem is the danger that corporate conduct may result in negative externalities and harm to society).

162. See, e.g., BLACKROCK, supra note 28, at 8–9 (stating many managers are beginning to emphasize ESG factors.)
change, sustainability, and gender diversity on boards, as inherent aspects of risk management, and these issues now account for the majority of all shareholder proposals filed in the United States. Also, a growing number of international Shareholder Stewardship Codes explicitly refer to investor stewardship responsibilities regarding ESG. For example, the 2020 UK Shareholder Stewardship Code for the first time explicitly recognizes the growing importance of ESG matters to institutional investors.

One recent paper effectively flips the central argument of anti-common ownership scholars on its head, by arguing that portfolio-regarding intervention by the largest institutional investors may have beneficial outcomes from a social welfare perspective. The paper argues that large diversified investors are, indeed, sometimes prepared to exert their growing power over individual firms for the benefit of their portfolio companies, but that, rather than seeking to reduce competition, they do this to control the effects of firm-level negative externalities of climate change on their entire portfolio. This development contradicts not only the profit-focused Versions 2 and 3 of common ownership but also Version 1, the lazy investor narrative.


164. See, e.g., Larry Fink’s 2020 Letter to CEOs, supra note 163; Landy, supra note 163 (discussing BlackRock’s proposed exit from investments in coal producers and search for more sustainable investments).


167. See Jennifer G. Hill, Good Activist/Bad Activist: The Role of International Stewardship Codes, 41 SEATTLE U. L. REV. 497 (looking at stewardship codes to examine the positive activist role of shareholders).


169. See Condon, supra note 131 (arguing that institutional investors have become more willing to advertise their role in seeking emissions reductions commitments).

170. See id. (arguing that diversified investors should rationally be motivated to internalize negative externalities within their portfolio).

171. See id. (arguing that institutional investors can influence decisions at the firm level to benefit their portfolio, challenging the rationally reticent model of investors).
V. CONCLUSION

Anti-common ownership scholars propose an intriguing theory, but further empirical studies are required to determine whether it accords with reality. The regulatory prescriptions offered by the more extreme versions of the common ownership narrative would have dire regulatory consequences and result in wholesale discrimination against certain shareholders. They would effectively unravel the benefits of investment diversification and democratization of wealth.\textsuperscript{172} If further studies determine that there are indeed “hidden costs”\textsuperscript{173} to common ownership, the role of the law should be to craft an effective, but appropriately targeted, response to that problem.

\textsuperscript{172} See BLACKROCK, supra note 28, at 1 (explaining that remedies for common ownership would negatively affect diversified investment strategies and index investing).

\textsuperscript{173} Partnoy, supra note 37.