THE TRIANGULATION OF THE AMERICAN ECONOMY: A PROPOSAL TO COMBAT CORPORATE CONCENTRATION

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> "[W]ealth is constantly at our door, but men are needed to gather and utilize it; . . . these massive combinations impoverish the nation in its constructive business men; . . . they destroy independence, shatter hopes, and make for a nation of clerks and subordinates, instead of men and masters."[1]

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[1] *See* Pam, *infra* note 112, at 468.

INTRODUCTION

A recent shift in capital has ballooned passive investment funds into some of the largest financial entities in the world. The three largest of these, BlackRock, Vanguard, and State Street, have amassed assets under management portfolios that are nothing short of staggering.[2] This massive surge of investment capital has also provided these firms with an opportunity to exercise corporate power through coordinated voting strategies and direct engagement,[3] the scope of which this country has not seen since World War I. This concentration of corporate power gives rise to anticompetitive concern.

However, surely if our antitrust laws were adequate, or perhaps adequately enforced, this issue could be addressed, but it has continued to compound, unchecked and unfettered. This article will examine current antitrust methods and philosophies and the adequacy of their application to the corporate concentration problem. Further this article seeks to formulate a new approach which might address the corporate concentration problem, while still allowing these passive index funds to be the most popular retail investment for the average consumer.

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[2] *See generally* Assets Under Management figures, *infra* notes 17, 18, and 19.

[3] Jan Fichtner et al., *Hidden Power of the Big Three? Passive index funds, re-concentration of corporate ownership, and new financial risk*, 19(2) BUS. & POLS. 298, 306-07 (2017).

I. THE LANDSCAPE OF CORPORATE CONCENTRATION

Diversified mutual funds first rose to prominence as a financial service in the 1970s.[4] These funds afforded investors the opportunity to receive the benefit from a market-wide array of investments while only having to purchase one asset.[5] Since the financial collapse of 2008, a monumental shift in capital has taken place, away from "actively managed mutual funds", and towards "passive index funds."[6] These passive index funds invest with the goal of replicating market growth by buying representative amounts of shares of a given index's listed companies and in turn holding them either in perpetuity, or until the composition of the index is altered.[7] This approach differs most significantly from actively managed funds in that it minimizes the expenses associated with hand-picked, overly active, broker-managed funds.[8] Prior to 2008, many investors saw beyond the high expenses in the hopes that fund managers could outperform the market.[9] Recently, investors have recognized that these fund managers rarely achieve this goal and opt for the low expense, consistent growth option.[10]

This inordinate shift in capital is evidenced by the fact that from the collapse of 2008 to 2015, nearly $800 billion of actively managed holdings were sold, and, in the same time span, nearly $1 trillion of passively managed holdings were purchased.[11] This passive index fund industry is dominated by three companies: BlackRock, Vanguard, and State Street (collectively the "Big Three").[12] These three companies have captured a whopping 71% of the passive index market.[13]

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[4] Fiona Scott Morton & Herbert Hovenkamp, *Horizontal Shareholding and Antitrust Policy*, 127 YALE L.J. 2026, 2028 (2018).
[5] *Id.*
[6] Fichtner et al., *supra* note 3, at 298-99.
[7] *Id.* at 299-300.
[8] *Id.* at 299. *See also* Morton & Hovenkamp, *supra* note 4, at 2028.
[9] *See* Fichtner et al., *supra* note 3, at 302.
[10] *Id.* at 302-04.
[11] *Id.* at 299.
[12] *Id.*
[13] *Id.* at 303-04. In December 2016, BlackRock held 37%, Vanguard held 18.5%, and State Street held 15.5%.

In 2001, the Big Three were listed as the largest shareholders in only 25% of the companies listed in the S&P 500.[14] In 2017, they were the largest shareholders for a staggering 88% of the companies listed in the same index.[15] Said differently, the Big Three were the largest shareholders for "438 of the 500 most important American corporations."[16]

In 2022, BlackRock, Vanguard, and State Street represented $8.5 trillion,[17] $8 trillion,[18] and $3.5 trillion[19] in assets under management respectively. BlackRock and Vanguard's individual portfolios of $10 and $8 trillion surpassed every country's GDP except only the U.S. and China.[20] Further, the Big Three's assets under management combined—a total of roughly $20 trillion—exceeded every official GDP figure except the United States' $25 trillion.[21] The total assets under management figure for all three firms does not suggest some collusion or concerted effort between them. In fact, despite their common investment strategies and financial services, the firms differ in their individual governance structures.[22]

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[14] *See* Morton & Hovenkamp, *supra* note 4, at 2029.
[15] *See* Fichtner et al., *supra* note 3, at 313.
[16] *Id.*
[17] *See* BLACKROCK, 2022 ANNUAL REPORT, https://s24.q4cdn.com/856567660/files/doc_financials/2022/ar/online/index.html#/financial-highlights [https://perma.cc/SL2Q-VA8G].
[18] *See Assets under management (AUM) of Vanguard in selected years from 1975 to 2024*, STATISTA, https://www.statista.com/statistics/1260855/vanguard-aum/ [https://perma.cc/7HB3-4NAA] (last visited June 16, 2024).
[19] *See Despite Inflation Fears and Higher Interest Rates, State Street Survey Finds More Than Two Thirds of Institutional Investors Continue to Grow Private Markets Allocations*, STATE STREET (Feb. 6 2023), https://investors.statestreet.com/investor-news-events/press-releases/news-details/2023/Despite-Inflation-Fears-and-Higher-Interest-Rates-State-Street-Survey-Finds-More-Than-Two-Thirds-of-Institutional-Investors-Continue-to-Grow-Private-Markets-Allocations/default.aspx [https://perma.cc/K22K-7LU3].
[20] *Gross Domestic Product 2022*, WORLD BANK (July 1, 2023), https://databankfiles.worldbank.org/public/ddpext_download/GDP.pdf [https://perma.cc/R7QP-XV7U].
[21] *Id.*
[22] *See* Fichtner et al., *supra* note 3, at 305.

BlackRock, the largest of the three, is publicly traded and, thus, under a fiduciary obligation to maximize returns for its shareholders.[23] In contrast, Vanguard, the second largest, is "mutually owned by its individual funds and thus ultimately by the investors in these funds."[24] This removes from Vanguard the fiduciary responsibility to shareholders and allows them to operate with the lowest fees in the sector by operating "at-cost."[25]

The ultimate result of this indexing strategy is what has been coined as "horizontal shareholding" or "common ownership", which "occurs when a number of equity funds own shares of competitors operating in a concentrated product market."[26] This phenomenon has risen correlatively with the growth in scope of index funds. In 1980, less than 10% of publicly traded American companies shared institutional investors with their direct market competitors.[27] In 2014, that number had risen to 60% and is presumably even higher today.[28] Due to the Big Three's size and scope, their pervasive and almost exclusive common ownership throughout virtually every industry gives reason for pause. The Clayton Antitrust Act provides:

> No person shall acquire, directly or indirectly, the whole or any part of the stock or other share capital . . . or any part of the assets of one or more persons engaged in commerce or in any activity affecting commerce . . . [where] the effect of such acquisition, of such stocks or assets, or of the use of such stock by the voting or granting of proxies or otherwise, may be substantially to lessen competition, or to tend to create a monopoly.[29]

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[23] *Id.* Not to be confused with the purchasers of BlackRock's offered index funds, shareholders are the holders of stock in the company.
[24] *Id.*
[25] *Id.*
[26] *See* Morton & Hovenkamp, *supra* note 4, at 2027.
[27] *Id.* at 2029.
[28] *Id.*
[29] 15 U.S.C. § 18.

The Clayton Act establishes that when common ownership falls outside the investor exception, and "substantially lessens competition" or creates a monopoly, it is violative of the law.[30]

The "passive" designation these funds share suggests that the firms providing these services would take a "passive" approach, rendering any concerns to this effect moot. However, comments from CEOs of both BlackRock and Vanguard explicitly state that the term "passive" does not encompass their approach to the corporate governance of their investments.[31] These large institutional investors adopting an active approach to corporate governance while simultaneously exercising such a pervasive degree of common ownership raises concerns about softening competition and pushing a market-wide corporate agenda independent of the will of the American people.[32]

Investment firms can typically exert direct pressure on the corporate governance of their investments either by proxy voting or direct engagement with the managers of the company.[33] Further, they can act indirectly through the implicit threat that the institutional investor might liquidate its position in the company if it is unhappy with management.[34] Many investors of the past utilized this indirect, implicit approach—known as the "Wall Street Walk"—because they viewed it as a much easier approach and equally as effective.[35] However, due to the perpetual nature of passive indexing investment, firms such as the Big Three have adopted the more direct approaches of voting and direct engagement.

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[30] *Id.* ("This section shall not apply to persons purchasing such stock solely for investment and not using the same by voting or otherwise to bring about, or in attempting to bring about, the substantial lessening of competition.").
[31] *See* Fichtner et al., *supra* note 3, at 300 ("In the words of William McNabb, Chairman and CEO of Vanguard: 'In the past, some have mistakenly assumed that our predominantly passive management style suggests a passive attitude with respect to corporate governance. Nothing could be further from the truth.' In a similar vein, Larry Fink, founder, CEO and Chairman of BlackRock writes in a letter to all S&P 500 CEOs that he *requires* them to engage with the long-term providers of capital, i.e., himself.").
[32] *See* Morton & Hovenkamp, *supra* note 4, at 2030.
[33] See Fichtner et al., supra note 3, at 306-07.
[34] *Id.*
[35] *Id.* at 306.

These firms unabashedly and openly speak about their direct engagement.[36] "When we engage successfully and companies adjust their approach, most observers are never aware of that engagement . . . ."[37] "We typically only vote against management when direct engagement has failed . . . ."[38]

"We have found through hundreds of direct discussions every year that we are frequently able to accomplish as much–or more–through dialogue as we are through voting."[39] There are two legitimate reasons for firms like the Big Three to adopt this active approach. First, there is a school of thought that investors should exercise their rights as shareholders to prevent the company's managers from becoming too powerful.[40] However, in a situation such as the current one—with such pervasive levels of common ownership—it is not clear that the consolidation of power at the institutional investor level is better than the same consolidation at the management level.

The second reason is that, because passive funds effectively hold their positions in perpetuity, they have a vested interest in the long-term stability of the companies they have invested in.[41] However, this too seems to be misguided. Index funds seek to replicate overall market growth. If one company is run poorly and suffers, its competitors—of which the Big Three are most likely investors—should increase in value. The "stewardship" resulting from this active investor class appears to be more of a market manipulation when viewed in this context.

Another interesting phenomenon occurs when we look to the voting behaviors of the Big Three. All three firms massively expanded their corporate governance teams in 2016.[42]

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[36] *See* Morton & Hovenkamp, *supra* note 4, at 2030-31.
[37] *Id.* at 2030.
[38] *Id.*
[39] *Id.* at 2031.
[40] Fichtner et al., *supra* note 3, at 309.
[41] *Id.* ("As Vanguard explains: 'Because the funds' holdings tend to be long term in nature (in the case of index funds, we're essentially permanent shareholders), it's crucial that we demand the highest standards of stewardship from the companies in which our funds invest.'").
[42] *Id.* at 308.

Despite the diverse needs and strategies employed by the multiple funds under the respective umbrellas of the Big Three, their proxy voting is stunningly consistent.[43] BlackRock experienced mixed votes across its funds in only 18 of every 100,000 of the proposals garnering a vote.[44] Vanguard is even more monolithic with mixed votes occurring in only 6 per 100,000 votes.[45]

State Street shows the highest level of internal disagreement with mixed votes occurring 195 times per every 100,000 voting instances.[46] While State Street's frequency of mixed voting is much higher than the other two firms, its rate of mixed voting is given perspective when viewed against that of Fidelity—the fourth largest index fund who adopts a more classic approach to active investing—who evinces internal disagreements in 3,144 votes per every 100,000 voting instances.[47]

This unprecedented consistency in proxy voting tends to suggest that the various funds comprising each firm are subscribed to a firmwide agenda regardless of their varying interests in the given companies.[48] Further, 90% of the time, institutional investors side with the management recommendation, with the only tangible exception being management re-election votes.[49] This reinforces the idea that these firms seek to shape corporate governance on the front end through direct engagement and only unleash their centralized voting power when they feel a shift in management is warranted. "In the words of Larry Fink, CEO of BlackRock: 'As an indexer, our only action is our voice and so we are taking a more active dialogue with our companies and are imposing more of what we think is correct.'"[50]

As these funds continue to balloon to unprecedented magnitudes, their power as shareholders will also increase.

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[43] *Id.* at 316-17.
[44] *Id.*
[45] *Id.*
[46] *Id.*
[47] *Id.*
[48] *Id.*
[49] *Id.* at 317-18.
[50] *Id.* at 318.

This level of concentration of corporate power has not been seen since the Gilded Age and its magnates, J.P. Morgan and John D. Rockefeller.[51] However, unlike their direct and open attempts to concentrate corporate power through mergers and board memberships, the Big Three have employed a more subtle, hidden tactic.[52]

Further, as they grow, these passive funds will increasingly become the building blocks of investment portfolios, not only because of their stable returns, but also because every share they buy and hold in perpetuity is another share out of circulation.[53] This only compounds the issues surrounding the concentration of corporate control because the investors purchasing these offerings do not receive shareholder power; they merely receive returns from the fund.[54]

Every injection of capital from investors purchasing these indexing services will actually increase the shareholder power of the Big Three, as it is them, who actually hold the shares of the various companies.[55] In essence, the Big Three are becoming middlemen between most investors and publicly traded companies, creating a situation in which the investor gets market correlative returns, and the fund receives all of the shareholder power. For firms such as BlackRock, this is even more troublesome due to its structure as a publicly traded entity. In such a situation, BlackRock receives all the shareholding power from the purchasers of its services, but its obligation is to its shareholders, who now exert unprecedented levels of corporate control across the entire economy.[56]

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[51] *Id.* at 315.
[52] *Id.*
[53] *Id.* at 321.
[54] *Id.* at 322.
[55] *Id.*
[56] *See* Fichtner et al., *supra* note 3, at 305.

II. QUANTITATIVE METRICS

To truly understand how the Big Three have amassed such a pervasive level of corporate concentration in seemingly broad daylight, we must first look to popular quantitative metrics used to quantify anticompetitive effect and why those metrics fail to capture the nefarious nature of Big Three investments.

A. The HHI

The Department of Justice's foundational metric of market concentration is the Herfindahl-Hirschman Index ("HHI").[57] The Department views market concentration as a useful, though not omniscient, indicator of whether a horizontal merger will result in an anticompetitive effect for the given market.[58] The agencies' treatment of market concentration suggests that its reliability has a positive correlation to how stable the measure of market shares has been over a given time (i.e. the longer market shares have been stable, the more reliable market concentration seems to be as an indicator).[59] The HHI measures market concentration by "summing the squares of [all] individual firms' market shares."[60] In analyzing a specific transaction, the agencies will look to both the post-transaction HHI and the change in HHI as a result of the transaction.[61]

The agencies break down HHI measurement into three categories: (1) unconcentrated markets: HHI<1500; (2) moderately concentrated markets: 1500<HHI<2500; and (3) highly concentrated markets: HHI>2500.[62] Further, agency guidance for

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[57] *See* U.S. DEP'T. OF JUST. & FED. TRADE COMM'N, HORIZONTAL MERGER GUIDELINES § 5.3, at 18 (Aug. 19, 2010).

[58] *Id.* ("The purpose of these thresholds is not to provide a rigid screen to separate competitively benign mergers from anticompetitive ones . . . . Rather, they provide one way to identify some mergers unlikely to raise competitive concerns and some others for which it is particularly important to examine.").

[59] *Id.*

[60] *Id. See also Herfindahl-Hirschman Index*, ANTITRUST DIVISION, U.S. DEP'T OF JUST., https://www.justice.gov/atr/herfindahl-hirschman-index [https://perma.cc/J43X-MPBK] (last updated Jan. 17, 2024).

[61] *See* U.S. DEP'T OF JUST. & FED. TRADE COMM'N, *supra* note 57, at 18-19.

[62] *Id.* at § 5.3, at 19.

treatment of this measurement provides the following: a merger creating an increase in HHI of less than 100 likely requires no further analysis, a transaction resulting in an unconcentrated market likely requires no further analysis, a merger which creates a moderately concentrated market and raises the HHI by more than 100 points warrants review, and a merger which creates a highly concentrated market and raises HHI by 100 points warrants review.[63] Further, where a transaction in a highly concentrated market raises HHI by 200 or more points, it creates a rebuttable presumption that the merger will increase market power beyond permissible limits.[64]

A rather simplistic example can show how the HHI measures market concentration. Assume a given market is comprised of six firms: A, B, C, D, E, and F. Firm A possesses 30 percent market share, Firms B and C each possess 20 percent, and Firms D, E, and F each possess 10 percent.

HHI = $30^2+20^2+20^2+10^2+10^2+10^2$ = 2000 (Moderately Concentrated).

Now assume Firm A acquires both Firms D and E, increasing Firm A's market share from 30% to 50%. The post-merger HHI calculation would be:

HHI = $50^2+20^2+20^2 + 10^2 = 3400$

This post-merger HHI would be well beyond the 2500-point threshold and qualify as a highly concentrated market. Further, the hypothetical transaction would result in a 1400-point increase. Per FTC guidelines, such a transaction would create a rebuttable presumption that Firm A's market power would be increased beyond permissible limits without agency intervention.

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[63] *Id.*
[64] *Id.*

The HHI functions as a rudimentary signal for when a merger may be problematic, but it fails to capture potential changes to the concentration-price relationship brought about by more nuanced financial relationships, such as partial ownership.[65] Take for example, a scenario in which Firm A—from the preceding example—rather than acquiring Firms D and E outright, purchased a partial ownership interest in each. Because there is no merger or ownership, the market share for Firm A would remain unchanged. Therefore, HHI would remain unchanged despite this new, significant relationship between three of the six firms participating in the market.

Accordingly, modifications to the HHI have been proposed as an attempt to capture the anti-competitive effect of partial ownership structures.

B. The MHHI

The Modified Herfindahl-Hirschman Index ("MHHI") emerged from economic scholars as an extension of HHI first aimed at quantifying the competitive incentive effect of joint ventures (by Bresnahan and Salop), then quantifying the competitive incentive effect of partial ownership (by O'Brien and Salop).[66] Since the MHHI was formulated as an expansion of the HHI, it is built upon the "Cournot oligopoly model of quantity competition," a foundational presupposition of the HHI.[67] The MHHI is most easily understood to equal the HHI of a given market plus an MHHIΔ.[68] These MHHIΔs can apply to a generalized version of MHHI, proposed by O'Brien and Salop, where the MHHI is equivalent to the HHI plus a summation of the various deltas which might arise from partial ownership interests.[69] This generalization is aimed at

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[65] Daniel P. O'Brien & Steven C. Salop, *Competitive Effects of Partial Ownership: Financial Interest and Corporate Control,* 67 ANTITRUST L.J. 559, 594-95 (2000).
[66] Daniel P. O'Brien & Keith Waehrer, *The Competitive Effects of Common Ownership: We Know Less Than We Think*, 81 ANTITRUST L.J. 729, 735, 737 (2017).
[67] *See* O'Brien & Salop, *supra* note 65, at 595.
[68] Menesh S. Patel, *Common Ownership, Institutional Investors, and Antitrust*, 82 ANTITRUST L.J. 279, 294 (2018).
[69] *See* O'Brien & Salop, *supra* note 65, at 597-98 (mathematically expressed as:

weighting the HHI based on common ownership interests present in the given industry.[70] The generalization is also presupposed by the assumption that the manager of each firm "maximizes a weighted sum of the owners' financial returns, which include the owners' earnings through their financial interests in other firms in the same market."[71]

These respective weights are regarded as "control weights" and serve as a quantitative metric for the amount of control an owner can exercise over the management of the given firm.[72]

While this metric appears mathematically labyrinthine and might certainly become so under certain investment scenarios, it is conceptually quite intuitive. In any given market where there is no common ownership, the MHHIΔ will equal zero.[73] In such a scenario, the HHI and MHHI would be equivalent because the MHHIΔ provides no modification. However, if some degree of common ownership is added to the above example, the MHHIΔ will rise according to the control weight created by the common ownership to a number larger than zero, and that number plus the HHI will equal the MHHI.[74] Some scholars have asserted that, although the industry is in fact a Cournot oligopoly, the MHHI can be set against a "Lerner Index" as a way of quantifying competitive harm.[75]

$MHHI = HHI + \Sigma_j \Sigma_{k \neq j} \{(\Sigma_i \gamma_{ij} \beta_{ik})/(\Sigma_i \gamma_{ij} \beta_{ij})\} S_k S_j$; where "$\beta_{ij}$ is the fraction of firm j that is owned by owner i, and γ_{ij} is the weight that that manager of firm j places on owner i's profits in calculating the profits of firm j.").

[70] *See* Patel, *supra* note 68, at 294-95.

[71] O'Brien & Waehrer, *supra* note 66, at 739.

[72] *Id.* ("By adjusting these 'control weights,' an analyst can employ this approach to capture virtually any control scenario.").

[73] *See* Patel, *supra* note 68, at 295.

[74] *Id.*

[75] *Id.* at 295-96 (using the specific notation: $(P-C)/P=MHHI/\varepsilon$; where "P [is] the market price[,] C [is] the share-weighted average marginal cost[, and] ε represents the elasticity of market demand . . . at the market level of output.").

C. Shortcomings of the HHI and MHHI

As the name suggests, the MHHI is a modification of the HHI aimed at updating market share concentration analytics so that they may be viable not just in merger analysis, as was originally intended, but also in measuring anticompetitive price effect in the context of common owners. This school of thought, however, is far from conclusive and not without substantial scrutiny.[76]

The first defect in these metrics are the various issues arising due to endogeneity. In the context of HHI, endogeneity occurs for two reasons. First, market structure and firm performance are properly viewed as a two-way feedback loop.[77] This evolution of markets makes common sense. Over time, people invest in profitable companies and do not invest in unprofitable ones; this allows the profitable business to grow, increasing its market share while the unprofitable one withers.[78] This situation would drastically change an HHI analysis and might even result in the industry being classified as a "highly concentrated market."[79] However, these events could transpire as a result of ingenuity on the part of a successful business that allows them to produce and sell their competitive product at a much lower price.[80] This situation would yield a monopolistic HHI directly caused by extreme competition in pricing and output.[81]

Second, in situations where demand and prices cannot be quantified precisely, a given firm's production and revenue are likewise endogenous.[82] In such a circumstance, the measure of concentration would have to be considered endogenous because it is entirely based upon endogenous variables.[83]

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[76] *See generally* Morton & Hovenkamp, *supra* note 4, at 2032 ("[M]ore work needs to be done before this metric can be accepted as the preferred basis for empirical work or litigation.").
[77] William N. Evans et al., *Endogeneity in the Concentration-Price Relationship: Causes, Consequences, and Cures,* 41 J. Indus. Econs. 431, 432 (1993) ("To oversimplify… concentration causes price, but price also causes concentration.").
[78] *Id.*
[79] *See* U.S. DEP'T. OF JUST. & FED. TRADE COMM'N, *supra* note 57, at 18-19.
[80] *See* Evans et al., *supra* note 77, at 432.
[81] *Id.*
[82] *Id.* at 433.
[83] *Id.*

As a derivation of the HHI, the MHHI shares in this endogeneity problem.[84] The aforementioned scenario of intense competition granting one firm the lion's share of an industry due to its own innovation could yield a similar result under an MHHI analysis, rendering an ultra-competitive market highly concentrated.[85] This outcome highlights the unfortunate truth that, at their core, these metrics were designed to measure market concentration, not gauge anticompetitive price effect.[86]

Third, HHI and MMHI are derivative of market share concentration, and Big Three investment does not capture any percentage of the markets in which they invest. "Market share [can] be based on dollar sales, units sold, capacity, or other measures that reflect the competitive impact of each firm *in the market*."[87] A firm, such as BlackRock's, market share lies within the financial sector. They could theoretically invest in every single airline company to an extent which would provide them the opportunity for direct engagement or voting, but they would not, in so doing, capture a single percentage point of the airline market. Some scholars have attempted to skirt around both this defect and endogeneity concerns by modifying the analysis to not include market share at all, opting instead to substitute market share for a quotient obtained by dividing the sum of horizontal shareholdings by the number of competitors.[88] However, as Elhauge points out, like mergers, horizontal shareholdings' quantifiable anticompetitive effects flow from market concentration.[89]

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[84] *See* O'Brien & Waehrer, *supra* note 66, at 743.
[85] *Id.*
[86] *Id.* (explaining that HHI is only regarded as a factor for consideration in merger analysis and not a dispositive threshold test).
[87] *Competitive Effects Guidance*, FED. TRADE COMM'N, https://www.ftc.gov/advice-guidance/competition-guidance/guide-antitrust-laws/mergers/competitive-effects [https://perma.cc/E32C-MGR4] (last visited June 16, 2024) (emphasis added) (alteration in original).
[88] *See* Jacob Gramlich & Serafin Grundl (2017) *Estimating the Competitive Effects of Common Ownership*, *in* FINANCE AND ECONOMICS DISCUSSION SERIES 2017-029, https://doi.org/10.17016/FEDS.2017.029r1 [https://perma.cc/N2KM-2KRY](advocating for the use of a generalized HHI denoted as the GHHI).
[89] Einer Elhauge*, How Horizontal Shareholding Harms our Economy – and Why Antitrust Law Can Fix It,* 10 HARV. BUS. L. REV. 207, 237 (2020).

Lastly, the mare's nest created by this impulse to quantify a market concentration price effect does virtually nothing to address the key issue of corporate concentration. These methods could only incidentally provide a remedy where the remedial measure to rectify the possible anticompetitive pricing coincidentally forces one of these firms to diminish their holdings in a concentrated industry to such a degree that their holdings would no longer afford them direct engagement or voting opportunities among competitors. Implicit in this approach is the notion that, provided firms such as the Big Three could avoid having their investments register on the MHHIΔ Richter scale, they could directly engage with and actively shape the corporate governance of every publicly traded firm in the American economy.

Such a result is in no way congruent with the competition-centric policy that undergirds our antitrust legislation and is simply intolerable to our economic system and national ideals. This concentration of corporate governing power cannot go unchecked. In the search for a new approach, we need not attempt to start from scratch. There are certain adaptations to our existing policies that could feasibly check the scope of this power and allow citizens who do not share in the corporate vision of the Big Three to invest their money and engage in their commerce free of the Big Three's control.

III. POTENTIAL REMEDIES

This section will examine some of the most noteworthy solutions by leading scholars to the competitive problems caused by Big Three investment and explain how these approaches illuminate how the Big Three have managed to circumvent antitrust legislation. Further, this section will provide an alternative solution which seeks to strike a fair balance between allowing the Big Three to generate large profits for themselves and their investors, while also curtailing the current unfettered concentration of corporate control.

A. Elhauge's MHHIΔ Expansion to the Clayton Act

Various scholars have posited potential remedies for the possible ills resulting from common ownership. Einer Elhauge has proposed a rather straightforward approach under the Clayton Act.[90] Elhauge's approach recognizes that the anticompetitive effect is not only present at the time of a given transaction but can also occur after a stock is held for an extended period of time.[91] This recognition leads Elhauge to the conclusion that the appropriate test of illegality under the Clayton Act would "require a showing that horizontal shareholdings have adverse price effects for some significant time period," affording the institutional investors the opportunity to remedy the issue without agency intervention by managing their portfolios in such a way that they avoid a quantifiable, anticompetitive price effect.[92]

Elhauge further posits that agency investigations should be triggered when a horizontal stock acquisition creates, or will create, "a ΔMHHI of over 200 in a market with an MHHI over 2500."[93] While this approach follows a very logical understanding of the plain language of the Clayton Act and could be a useful approach when horizontal shareholding yields anticompetitive pricing, it could only combat the underlying issue of corporate concentration coincidentally, and only in the instances where these passive index funds are too careless and allow their holdings to produce an anticompetitive effect.[94]

Further, in this model, these large institutional investors seem to be granted free reign to exercise unprecedented levels of corporate control across virtually every industry, provided that no single transaction creates too big of a ripple in a too concentrated market and prices remain competitive.

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[90] *Id.* at 255-56.
[91] *Id.* at 257 (quoting United States v. ITT Cont'l Baking Co., 420 U.S. 223, 240-42 (1975)).
[92] *Id.* at 258.
[93] Einer Elhauge, *Horizontal Shareholding*, 129 HARV. L. REV. 1267, 1303 (2016).
[94] *See* Elhauge, *supra* note 89, at 257-58.

This price-centric, post-hoc analysis fails to penetrate to the heart of the matter and shows perfectly how the current antitrust approach is simply inadequate to deal with the multi-level concentration created by the Big Three.

B. Posner, Morton, and Weyl's Pure Passivity Approach

Posner, Morton, and Weyl's pure passivity approach reaches much closer to addressing the corporate concentration created by the Big Three, despite being grounded in the MHHI quantitative scholarship. Posner, Morton, and Weyl posit that the proper solution lies with a policy which would incentivize investment firms such as the Big Three to "un-diversify" in each given industry while still allowing them to diversify their holdings across all industries.[95] Posner, Morton, and Weyl assert that limiting a firm's ability to diversify within an industry would not bar said firm from reaping the benefits of diversification, because their industry boundaries would be drawn much more narrowly than before, creating roughly ten times as many industries.[96] They further rationalize this restriction by citing statistics which show that a randomly generated investment portfolio comprised of 49 stocks, evenly spread across all industries, could theoretically yield "more than 90 percent of the available diversification."[97]

Turning now to the proposal, Posner, Morton, and Weyl put forth:

> No institutional investor or individual holding shares or more than a single effective firm in an oligopoly may ultimately own more than 1% of the market share unless the entity holding

[95] Eric A. Posner, Fiona M. Scott Morton, & E. Glen Weyl, *A Proposal to Limit the Anticompetitive Power of Institutional Investors*, 81 ANTITRUST L.J. 669, 698-99 (2017) ("or as we will put it, to 'concentrate' their holdings within a small number of firms within each industry").

[96] *Id.* at 710.

[97] *Id.* (citing John Y. Campbell et. al., *Have Individual Stocks Become More Volatile? An Empirical Exploration of Idiosyncratic Risk*, 56 J. FIN. 1 (2001)).

shares is a free-standing index fund that commits to being purely passive.[98]

Posner, Morton, and Weyl prudently classify different individual funds under management of a larger fund, such as the Big Three, as holdings of the larger fund.[99]

Thus, not allowing massive institutional investors to attempt to "dilute" their paper holdings by claiming their subsidiary funds are independent of the larger, overarching fund management.[100]

A fundamental presupposition to any policy built upon HHI and MHHI quantitation is that the given industry is a Cournot oligopoly.[101] Therefore, Posner, Morton, and Weyl assert that prior to enacting this policy, the Department of Justice and the Federal Trade Commission must compile an annual list of industries—from Posner, Morton, and Weyl's more narrow distinctions—to be formally classified as "oligopolies."[102] They also assert that the basis for this classification could be open-ended, weighing various competitive factors and concerns, but it would primarily be based upon an industry where the HHI is in excess of 2500.[103]

As a way of ensuring that this "oligopoly" classification does not produce an adverse effect on the given market, Posner, Morton, and Weyl posit that the ruling agency should explicitly state that the annual list of industries, would have "no legal force" in any setting other than "enforcing investor ownership of competitors."[104]

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[98] *Id.* at 708. ("An institutional investor is invested in more than a *single effective firm* if it is invested in more than one firm, *and* the total market share of all firms it holds any stake in is greater than *HHI*/10,000 in the oligopoly. The effective firm definition allows an institutional investor to hold multiple competing sufficiently small fringe firms instead of a large firm.") (emphasis in original).
[99] *Id. See also supra* Section I. Given the incredibly infrequent occurrence of mixed voting between the large management funds and their smaller, subsidiary funds, this a warranted and effective classification.
[100] *Id.*
[101] *See* O'Brien & Salop, *supra* note 65, at 595.
[102] *See* Posner, Morton, & Weyl, *supra* note 95, at 698.
[103] *Id.* (suggesting that perhaps HHIs ranging from 1500-2500 might also receive the designation). *See generally* U.S. DEP'T. OF JUSTICE & FED. TRADE COMM'N, *supra* note 57.
[104] *See* Posner, Morton, & Weyl, *supra* note 95, at 698. The authors " [n]ote that any uncertainty about whether to classify an industry as an oligopoly should be resolved in favor of classification because the incremental costs to doing so are small." *Id.* at 711.

Further, Posner, Morton, and Weyl advocate for the compilation of the list to occur early enough to allow time for solicitation of comments and to provide institutional investors one month to adjust their investments, where needed, to be in compliance with the list at its January 1 enforcement.[105] This hopefully necessary adjustment in holdings would necessitate a sale of holdings in the main firms of a given industry, from large institutional investors, such as the Big Three, to their smaller competitors.[106]

Posner, Morton, and Weyl address the market share issue created by "passive" institutional investors under an HHI/MHHI analysis by quantifying the investors' market share as a summation of all the firms in a given product industry, the share an investor is holding in a firm, and the market share of that given firm.[107]

Lastly, Posner, Morton, and Weyl introduce an alternative to their limits on diversification in the form of "pure passivity."[108] They assert that a purely passive index fund participates in no direct engagements, exerts no power over corporate governance, and invests proportionately across the market solely for the purpose of indexing.[109] The underlying principle for the safe harbor provision stems from the school of thought known as the "passive fund solution" and could curtail the exorbitant amount of corporate control amassed by firms like the Big Three.[110]

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[105] *Id.* at 709.
[106] *Id.* at 711-712.
[107] Expressed mathematically as: $\Sigma_j \beta_{ij} s_j$; where i is the investor, j is the firm, and s_j is the market share of firm j. *Id.* at 709. *See also supra* Section II (explaining how passive indexing can circumvent the market share calculation upon which HHI and MHHI are based).
[108] *Id.* at 679.
[109] *Id.* at 709. "An institutional investor could be allowed to own as much equity as it wants–within industries as well as across industries–as long as it (a) never communicates with the operational firms, (b) commits itself to 'mirror voting,' in which it votes the same as other shareholders do, and (c) commits to a clear, verifiable investment strategy, such as indexing that allows the investor no discretion in selling some stocks and buying others that could be used to punish firms . . . ." *Id.* at 712.
[110] *Id.* at 721.

C. A New Approach Grounded in Section 8 of the Clayton Act

The incessant impulse to quantify a market share derivative price effect highlights just how inadequately our current implementation of antitrust legislation deals with the corporate concentration enacted by the Big Three. As well reasoned as Elhauge's MHHIΔ is, it is completely mired in the pursuit of shoe-horning Big Three practices into the market concentration-price effect paradigm, and as such, fails to contend with the underlying concentration issue.

Elhauge's approach can only address the ills of corporate concentration coincidentally—in the instances where the entities wielding this corporate power produce an alteration in prices that produces an MHHIΔ in excess of 200 in an already concentrated market.[111] Such a policy could not be relied upon to curtail the concentration of corporate power.

The policy set forth by Posner, Morton, and Weyl comes much closer to reaching the mark despite being afflicted by the same HHI/MHHI foundation.[112] The crucial element to this policy is the safe harbor provision for purely passive investment funds, which might reach a similar outcome to the policy proposed by this article, but it does so in the pursuit of completely different approaches. While this article actively embraces the likelihood that the answer to this problem lies within the "passive fund solution," its policy is not in the pursuit of the un-diversification of institutional investment holdings.[113] Rather, its aim is to preserve the diversification of institutional investment holdings, while de-concentrating corporate control by adapting section 8 of the Clayton Act to more neatly apply to the reach of firms such as the Big Three.

Section 8 contains a rule against interlocking directorates: "No person shall, at the same time, serve as director or officer of any two corporations… that are: (A) engaged in whole or in part in commerce; and (B) by virtue of their business and location of operation, competitors, so that the elimination of competition by

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[111] *See* Elhauge, *supra* note 93, at 1303.
[112] *See* Posner, Morton, & Weyl, *supra* note 95, at 698.
[113] *Id.* at 698-99.

agreement between them would constitute a violation of any of the antitrust laws."[114]

Section 8's rule against interlocking directorates was prompted by the widespread practice of investment banking institutions, who placed their agents on the board of directors of the various corporations in which they were also investing.[115]

"At the time of the Clayton Act's passage, the members of the board of J.P. Morgan held 'over 341 directorships in 112 corporations.'"[116]

Such a widespread reach by the investment banking institutions led scholars of the day to realize that a policy allowing such a practice effectively permitted these institutions to control the various business policies of different corporations across the entire American economy.[117] Those scholars rightly pointed out that such a practice was "violative of freedom and independence of business and trade, and [was] contrary to both law and equity."[118] The chief concern underlying this assertion was the fear that any agent of the "long-term providers of capital" would be able to assert unfettered control over the direction of any firm in which they provided investment, because financial aid in the form of investment capital was the life-blood of nearly every publicly traded company.[119]

Finally, and most importantly, this rule against interlocking directors was not included in the Clayton Act because it yielded a quantifiable price effect compared to firms who were not subjected to interlocking directorates; it was enacted to take away the

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[114] 15 U.S.C. § 19.

[115] Max Pam, *Interlocking Directorates, The Problem and its Solution*, 26 HARV L. REV. 467, 469 (1913).

[116] Eric N. Fischer, *Serving More Than One Master: A Social Network Analysis of Section 8 of the Clayton Act*, 41 J. CORP. L. 313, 315 (2015) (quoting Arthur H. Taveras, Jr., *Interlocks in Corporate Management and the Antitrust Laws*, 46 TEX. L. REV. 819, 829 (1968)).

[117] *See* Pam, *supra* note 115, at 469-70.

[118] *Id.* at 469.

[119] *Id.* at 469-70. *See also* Fichtner et al., *supra* note 3 (quoting BlackRock CEO, Larry Fink).

opportunity for these directors to produce an anticompetitive effect before they ever had the opportunity to do so.[120]

While preemptive laws are typically unfavorable, a preemption of this practice is well grounded in the philosophical pillar that man is inadequate to serve two conflicting interests.[121]

The policy proposed by this article is as follows: Any investor or individual whose shareholdings afford the investor or individual corporate voting rights or the opportunity for direct engagement in multiple competing firms must make a public filing with the FTC, choosing one firm in the industry in which to exercise that power and relinquish those capabilities from all its competitors.

This policy would function as a useful compromise to the pure passivity approach by allowing these massive investment firms to exercise some corporate power while removing their pervasive corporate reach across various industries. Similar to the approach posited by Posner, Morton, and Weyl, the term "investor" under this policy would be construed to include subsidiary funds under the management of firms — such as the Big Three — as the managing funds' holdings.[122] Further, setting aside any potential squabbles over whether corporate voting rights and direct engagement constitute a directorate as contemplated by section 8, these practices could easily be classified as a sort of constructive directorate. The need for investment capital is no less necessary today than it was in 1913.[123]

Therefore, the effect of the direct engagement and corporate voting by these investment hegemons is no less persuasive. Under this approach, the test for whether corporations are competitors would be a factor test, mirroring the test for section 8: "(1) the extent to which the industry and its customers recognize the

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[120] TRW, Inc. v. F.T.C., 647 F.2d 942, 946-47 (9th Cir. 1981) ("The purpose of section 8 was 'to nip in the bud incipient antitrust violations by removing the opportunity or temptation for such violations through interlocking directorates.'") (citation omitted).

[121] *See* Wardell v. Union Pac. R. Co., 103 U.S. 651, 658 (1880) ("It is among the rudiments of the law that the same person cannot act for himself and at the same time, with respect to the same matter, as the agent for another whose interests are conflicting."). *See also* Matthew 6:24 (King James) ("No man can serve two masters: for either he will hate the one, and love the other; or else he will hold to the one, and despise the other.").

[122] *See* Posner, Morton, and Weyl, *supra* note 95, at 708.

[123] *See* Pam, *supra* note 115, at 469.

products as separate or competing; (2) the extent to which production techniques for the products are similar; and (3) the extent to which the products can be said to have distinct customers."[124]

The public filing would provide a crucial remedy to the issue of corporate concentration. The bright-line, pure passivity approach put forth by Posner, Morton, and Weyl is excellent in theory, but bright-line bans on activities tend to create a shadowy area for nefarious activity.[125]

Take prohibition-era bootlegging for example. The proper way to combat this corporate reach is not by forcing it into the shadows, but rather by subjecting it to full transparency.

This policy would necessitate a public filing, in which the investment firm would choose which corporation it would directly engage with. This would create a rebuttable presumption that any contact with the corporate governance apparatus of any of the chosen firm's competitors was nefarious and subject to an antitrust remedy, regardless of the investor's holdings in the competitor.

In turn, the rebuttable presumption would automatically shift the burden of proof onto the investment fund to show that their contact with the competing firm was not reasonably likely to affect their corporate governance. This approach would provide full transparency any time an investment fund sought to increase its corporate reach and, crucially, would provide an enforceable, partial passivity.

A transparent policy, which enforces this type of partial passivity, completely avoids altogether the quagmire of proving a quantifiable, anticompetitive price-effect by embracing the underlying approach to the rule against interlocking directorates. This too serves to "nip in the bud" any opportunity or temptation for an anticompetitive practice by preventing corporate governance structures from ever being in a situation where they are beholden to competing interests. The public filing would put any potential investor on notice that the firm chosen by one of these investment hegemons would be the subject of their direct engagement.

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[124] *TRW, Inc.*, 647 F.2d at 947.
[125] *See* Posner, Morton, and Weyl, *supra* note 95, at 709.

This could likely dissuade investment by entities or individuals whose interests are antithetical to the corporate visions of a firm such as BlackRock. This approach would also still allow these large index funds to fully invest across a given index so that its purchasers may receive an accurate yield for the given index, and this approach would not cap investment. Therefore, these funds could continue to invest as consumers purchase their services and avoid any potential fractional-reserve insolvency issues that might arise if consumers continued to inject money into these funds, but the funds were barred from investing the capital.

CONCLUSION

Since the 2008 financial collapse, there has been a seismic shift in capital towards passive investment funds.[126] This shift has bequeathed upon fund managers a concentration of corporate power not seen subsequent to the enactment of antitrust legislation.[127] The epicenter of this shift in capital is formed by three funds: BlackRock, Vanguard, and State Street. Much of the modern antitrust analysis revolves around quantitative metrics aimed at showing an anticompetitive price effect derived from market concentration analysis. These metrics fail to adequately combat corporate concentration for two reasons.

First, these investment companies are not altering the market share landscape of the industries in which they invest, because they do not capture any percentage of the market by simply investing. Second, even if scholars manage to adequately weight investor interest into a market share summation, these metrics fail to flag potentially troubling exercises of pervasive corporate power unless prices are anticompetitively influenced. Therefore, a new approach is necessary to combat this concentration. My approach de-concentrates the exercise of corporate power across these funds' various holdings, brings transparency to their direct engagement and voting strategies, and preserves the level and diversification their capital provides our economy.

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[126] *See* Fichtner et al., *supra* note 3, at 299.
[127] *Id.* at 315.

It is all but self-evident that the index funds provided by the Big Three are some of the most profitable financial instruments for investors all across the world. However, this profitability has planted the Big Three into the decision-making nebulous of a staggering percentage of the American economy. Whichever approach our regulators devise, a successful remedy preserves the profitability of the investment instrument, both for the firm and the investor, while also removing from funds such as the Big Three the ability to exert such sweeping corporate control.