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Common ownership by institutional investors and its impact on competition - Note by Mexico

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More documents related to this discussion can be found at www.oecd.org/daf/competition/common-ownership-and-its-impact-on-competition.htm

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Overview

1. This document aims to describe the practice of the Federal Telecommunications Institute (IFT) regarding the common ownership by institutional investors and its impact on competition. It provides a general overview of the analysis employed to: i) determine the ability of the institutional investors to influence the decision-making of the companies; and ii) to assess the potential coordinated effects derived from the common ownership by institutional investors. Finally, it presents a summary of some relevant IFT's cases on this issue.

1. Introduction

2. For the purposes of this document we will refer to institutional investors as organized and legal entities[1] that acquire stock, obligations, assets, securities or documents in several companies, generally a minority shareholding that does not allow them to control said companies. One example are investment funds.

3. According to the Mexican legislation framework, an entity with purely investment purposes is defined as that which acquires on behalf of their investors or partners, with limited rights, securities or participation in other economic agents for the sole purpose of obtaining returns for their investors, without having *de iure* or *de facto* control nor the intention to participate, manage or influence, directly or indirectly in the administration, operation, strategy or commercial policies of the economic agent.[2]

4. In the Mexican telecommunications and broadcasting sectors it is common to find these institutional investors holding shares in publicly listed companies.

5. In Mexico, common ownership by institutional investors has been relevant in the analysis of mergers' cases, in which the IFT has developed criteria regarding this particular issue.

6. Broadly speaking, the common ownership can potentially raise some competition concerns, mainly related to coordination effects. These concerns are associated to the existence of one or more investors that hold shares in different competitors, and those shares grant them the ability to influence the decision-making of the companies in a significant way.

[1] Çelik, S. and M. Isaksson (2013), "Institutional Investors as Owners: Who Are They and What Do They Do?", OECD Corporate Governance Working Papers, No. 11, OECD Publishing, Paris. http://dx.doi.org/10.1787/5k3v1dvmfk42-en

[2] See article 27 of the Regulatory Provisions of the Federal Economic Competition Law, available in Spanish at: http://www.dof.gob.mx/nota_detalle.php?codigo=5367678&fecha=10/11/2014

2. IFT Practices and Methodology

7. The IFT's Board of Commissioners has analyzed several cases where the common ownership by institutional investors has been a potential concern. Such analysis takes into account the following elements:

- To look for the institutional investors' participation in the economic agent.
- To look for the participation and the rights acquired by the institutional investors in competitors.
- To evaluate the type of rights acquired by any means, either in the economic agent or in its competitors, or in participants in other markets, in order to determine if the institutional investor can influence significantly their decision-making.
  - When the rights acquired in the economic agent and in its competitors do not generate the ability to influence the decision-making of the companies, the possibility of potential damage in the markets is discarded.
  - When the rights acquired in the economic agent and in its competitors generate the ability to influence the decision-making of the companies, an evaluation of the effects of the investment is required (especially the coordinated effects).

3. Elements Considered by the IFT to Determine the Existence of Significant Influence

8. In recent decisions the IFT has considered "significant influence" as the ability, *de iure* or *de facto*, of an economic agent to participate or intervene in a significant -but not decisive- way, directly or indirectly, by any means, in the decisions that include, but are not limited to, the administration, the definition of policies and objectives or the management, conduct and execution of the activities of another person(s).

9. It is important to highlight that the ability to influence the decision-making of the companies can be acquired by any means; and the analysis must be carried out on a case-by-case basis. The IFT uses as reference elements to identify the ability to influence, among others,[3] the following:[4]

- The ability or the right to designate, remove or veto at least one member of the board or an important director or manager or an equivalent that has the capability to take core decisions.
- The percentage of shares owned. The IFT has taken as a reference that a percentage greater than 10% of the shares with the right to vote or veto, grants the ability to influence the company's decision-making. This percentage is a benchmark. Under certain circumstances, a minor percentage that grants the right or the ability to intervene in the decision-making, can generate significant influence.

3 Other elements, not related to corporate rights in the definition of significant influence, have been considered.

4 See Reference elements to identify ex ante those economic agents impeded to have influence of the operation of the shared network, available in Spanish at: http://www.ift.org.mx/sites/default/files/contenidogeneral/temas-relevantes/elementos.pdf; and Merger Control Guidelines issued by IFT, available in Spanish at: http://www.ift.org.mx/sites/default/files/industria/temasrelevantes/9195/documentos/pift280617368.pdf.

10. Another element analyzed in cases of common ownership by institutional investors, is the framework for governance, accountability and investment practices of the investors. On a case-by-case basis, the IFT analyzes whether those elements can facilitate the ability to influence the decision-making of the companies.

4. Coordinated Effects

11. As mentioned above, if it is found that the shares held by an institutional investor grant the ability to influence the decision-making of firms that compete in the same market, to conduct an analysis of the coordinated effects is required.

12. Generally speaking, there is coordination among firms when each competitor determines its competitive strategy based on the behavior of the other participants, to a degree that limits or may limit their ability or incentives to compete independently.

13. The international practice recognizes that there is a high risk of coordination when there are structural links between economic agents that compete in one or various markets[5] that are prone to coordination, that in this case are generated from common ownership by an institutional investor in those economic agents.

14. In order to assess the feasibility of a coordinated behavior, the IFT considers the following elements:

- The markets' structure and levels of concentration. The probabilities of coordinated effects are greater among firms with high participation in the market and in highly concentrated markets;
- The scope of the structural link. Questioning to what extent the structural link allows or restricts participants to continue competing with each other independently;
- The financial interests that the structural link represents for each of the parties, compared with the revenues obtained by each firm in other economic activities in which they coincide as current or potential competitors;
- The organization and administration of the structural link, in order to determine whether it allows the parties to act independently. Competition risks are generated when the firms have the ability to influence the decisions in relevant issues like prices, production and other key points in the activities of the firms. The IFT has found that some institutional investors adopt "Chinese walls" that prevent or attenuate coordination risks;
- The feasibility to access or exchange information between the parties on other economic activities in which they are current or potential competitors, with the object or effect of restricting competition between the parties;
- The duration of the structural link. In general, when the duration is shorter, participants have more incentives to compete; and
- The entry feasibility of new competitors to the market. If it is timely, feasible and sufficient to counteract possible anticompetitive effects.

[5] ICN (2006), "ICN Merger Guidelines Workbook, ICN Merger Working Group: Investigation and Analysis Subgroup, International Competition Network", pp. 45-49, 74 y 79; and OECD (2008), "Minority shareholdings, Policy Roundtable"; and FTC y DOJ (2010), "*Antitrust Guidelines for Collaborations among Competitors*". Available at: https://www.ftc.gov/sites/default/files/documents/public_events/joint-venture-hearings-antitrust-guidelines-collaboration-among-competitors/ftcdojguidelines-2.pdf.

15. In the Mexican telecommunications and broadcasting sectors it is common to find institutional investors. When the IFT has analyzed the participation of institutional investors, no competition concern has arisen regarding their ability to influence the decision-making of markets' participants.

5. Relevant Cases

16. IFT's decisions regarding common ownership by institutional investors are based on the criteria generated in the analysis of several merger cases. A summary of some relevant cases is presented below.

5.1. Acquisitions of DirecTV, GSF Telecom and Nextel México by AT&T

17. On November 2014, the IFT authorized the acquisition of DirecTV by AT&T, subject to the fulfillment of remedies.[6] The merger was part of an international transaction with effects in the Mexican markets.

18. DirecTV has an indirect non-controlling stake in the capital stock of Innova, S. de R.L. de C.V. (Sky Mexico), a company owned by Grupo Televisa, S.A.B. de C.V. (GTV), which is a significant player in several markets of the telecommunications and broadcasting sectors in Mexico.

19. IFT found two investment funds (BlackRock and Vanguard Group) with common stockholding (the stake of the investment funds were relatively small) in AT&T, DirecTV, GTV and EchoStar Corporation (controller of Dish Mexico).

20. The conclusion of the analysis regarding the common ownership of equity by the investment funds was that there were no potential harms to the competition process in the markets in which AT&T, DirecTV, GTV and EchoStar participate in México, as the common ownership of equity did not constitute a coordination mechanism between the competitors.

21. The conclusion was based on the following elements:

- The capital stock held by the investment funds did not give them the ability or the right to designate, remove or veto none of the members of the board or an important director or manager or an equivalent.
- The stake held in GTV by the investment funds gave them only the right to vote for independent members of the board.

5.2. Acquisition of Level 3 Communications, Inc. by CenturyLink, Inc.

22. On September 2017, the IFT authorized the acquisition of Level 3 Communications, Inc. by CenturyLink, Inc. Level 3 was involved in the provision of internet services business, like cloud solutions and data centers. Previous to the acquisition, Century Link did not have presence in the Mexican market.[7]

[6] File UCE/CNC-003-2014, available in Spanish at: http://apps.ift.org.mx/publicdata/P_IFT_EXT_131114_225_Version_Publica.pdf

[7] File UCE/CNC-006-2014, available in Spanish at: http://apps.ift.org.mx/publicdata/VP_P_IFT_250917_593.pdf

23. Vanguard Group held minority stakes in the capital stock of Century Link and it was found that this investment fund owned capital stocks in some of the potential Century Link's competitors in the Mexican market.

24. The conclusion was that the common ownership in the capital stock of the competitors caused no potential harms to competition because the stake did not give them the ability or the right to designate, remove or veto none of the members of the board or an important director or manager or an equivalent. In addition, the regular practice of Vanguard Group is not to participate in the decision-making of the enterprises where they hold investments.

5.3. Acquisition of Passive Infrastructure from Axtel by MATC Digital

25. On October 2017, the IFT authorized the acquisition of passive infrastructure (142 telecommunications towers) from Axtel by MATC Digital.

26. The parties involved identified the indirect participation in the capital stock of MATC Digital by three investment funds that also held stakes in other competitors in the market affected by the operation (the stakes held by the investment fund were relatively small).

27. The conclusion was that the common ownership in the capital stock of the competitors caused no potential harms to competition because the stake did not give them the ability or the right to designate, remove or veto none of the members of the board or an important director or manager or an equivalent.

5.4. Acquisition of TVI by Grupo Televisa (GTV)

28. On February 2016, the IFT authorized, subject to conditions, a transaction by which Corporativo Vasco de Quiroga, S.A. de C.V. (CVQ) owned by GTV, acquired the control of Televisión Internacional, S.A. de C.V. (TVI) from Grupo Multimedios. In this case, the IFT did not find institutional investors holding stakes in the capital stock of the parties involved, however, it is presented as an example of the analysis carried out by the IFT in order to assess the coordinated effects derived from the minority shareholding of an investor in the capital stock of two competitors.

29. In its analysis, the IFT found several risks of coordinated effects arising from common ownership by one physical person in GTV and Grupo Multimedios. The risks of coordinated effects were identified in transmission services of television and radio signals. The elements that the IFT considered to determine the existence of a potential risk were the following:

- The level of market concentration. GTV and Grupo Multimedios are the biggest commercial television broadcasters in the northeast region of Mexico;
- Multimarket contact. GTV and Grupo Multimedios compete in seven local broadcasting markets, as well as in six local commercial radio markets;
- The number of competitors in the markets where GTV and Grupo Multimedios compete, which is low;
- The access to relevant information. Three members of the board of GTV were also members of the board of Grupo Multimedios; and
- The existence of entry barriers.

30. In this regard, the participation of the physical person in CVQ could facilitate the transfer of information for GTV and Grupo Multimedios to coordinate their activities in the markets in which they competed. The merger was approved subject to conditions aimed at avoiding potential harmful effects in the related markets.