The Virtue of Common Ownership in an Era of Corporate Compliance

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ABSTRACT: Recent years have seen a tremendous rise in common ownership, a structure in which large institutional investors have significant holdings in corporations that are horizontal competitors. Common ownership has long been the topic of scholarly debate with many scholars traditionally arguing that common ownership presents antitrust problems. Rather than enter into the antitrust debate, this Article argues that common ownership presents great virtue for corporate governance, and more specifically—corporate compliance.

In recent years the Department of Justice and other enforcement authorities have increasingly directed their resources towards enforcing laws that are typically oriented towards specific industries, such as healthcare (pharmaceuticals), financial and energy industries, or geographic areas. These laws—including the Foreign Corruption Practices Act, False Claims Act, Bank Secrecy Act, as well as laws and regulations aimed at preventing money laundering, environmental, and antitrust violations—expose companies associated with specific industries to heavy legal risks—which I term "macro legal risks."

This Article argues that institutional investors who hold shares in corporations in line with the common ownership structure are uniquely positioned to enhance the compliance of those corporations with industry-oriented laws, and to minimize exposure to macro legal risks. Institutional investors who invest in corporations that operate in the same industry can take advantage of three interrelated merits of common ownership: (1) enhanced incentives for monitoring compliance of corporations with industry-oriented laws, which accordingly leads to minimizing macro legal risks; (2) privileged access to rulemaking and lawmaking; and

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(3) experimental learning of macro legal risks. These merits allow institutional investors to better monitor corporations in which they invest and practice effective corporate governance and compliance.

The incentives of institutional investors increase due to increased aggregate exposure to problems affecting a certain industry. The difficulty of responding to these problems decreases as institutional investors are able to apply a one-size-fits-all approach to these problems, rather than develop individualized solutions for specific corporations. Due to their status as major asset holders, institutional investors develop close relationships with regulators and lawmakers, giving them a chance to influence regulation beyond the normal notice and comment process and anticipate trends in law and regulation. Finally, as a result of their wide holdings, institutional investors can apply knowledge gained in investigations and enforcement proceedings against a corporation to prevent these from happening to other corporations within the industry.

This Article is the first to analyze the benefits of common ownership in the area of corporate compliance. It argues that in an era of increasing enforcement based on industry-oriented characteristics, institutional investors who invest in line with a common ownership structure will become more active in overseeing corporate compliance and more effective in minimizing corporate wrongdoing.

I. Introduction

"Common ownership" describes a structure in which a small group of large institutional investors hold significant stakes in multiple firms in the same industry. Put differently, it refers to a structure in which institutional investors have significant ownership in horizontal competitors.[1] To illustrate, giant asset managers BlackRock, Vanguard, State Street Advisors and Fidelity are the top shareholders in each of the six largest banks in the United States: JPMorgan Chase, Wells Fargo, Bank of America, Citigroup, U.S. Bank and PNC.[2] These giant asset managers enjoy common ownership in other industries, including the airline, energy, and pharmaceutical industries.[3] Between 1980 and 2012 common ownership rates increased by 1600 percent to 2300 percent, depending on the method used to measure common ownership.[4] The emergence of this common ownership structure is attributed mainly to investors' decision to shift away from actively managed funds to passively managed index funds designed to replicate the return of a selected

1. Einer Elhauge, *Horizontal Shareholding*, 129 HARV. L. REV. 1267, 1267 (2016). This structure is also called "cross-ownership." *See, e.g.*, Edward B. Rock & Daniel L. Rubinfeld, *Defusing the Antitrust Threat to Institutional Investor Involvement in Corporate Governance* 3–4 (N.Y. Univ. Law & Econ. Research Paper Series, Working Paper No. 17-05, 2017), *available at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2925855 [https://perma.cc/73HC-ASTC].

2. *See, e.g.*, José Azar et al., Ultimate Ownership and Bank Competition 44 tbl.1 (May 4, 2019) (unpublished manuscript), *available at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2710252 [https://perma.cc/SW34-K6AT].

3. *See, e.g.*, José Azar et al., *Anticompetitive Effects of Common Ownership*, 73 J. FIN. 1513, 1514–16 (2018) [hereinafter Azar et al., *Anticompetitive Effects*].

4. Erik P. Gilje et al., The Rise of Common Ownership 19 (Apr. 19, 2018) (unpublished manuscript), *available at* https://ecgi.global/sites/default/files/The%20Rise%20of%20Common%20Ownership%20Paper.pdf [https://perma.cc/D4J4-X3YR].

index (e.g., S&P 500).[5] Index funds have become very popular over the past five to ten years,[6] which has helped accelerate the growth of common ownership.

Since its rise in popularity, common ownership has become the topic of heated debate. A growing body of scholarship now criticizes the common ownership phenomenon, arguing that it causes corporations "to compete less vigorously with each other," thereby harming consumers.[7] Accordingly, many scholars now call for legal and regulatory intervention in order to limit common ownership levels.[8] Furthermore, this criticism has spurred the Justice Department's investigation of potential antitrust issues arising from common ownership.[9] On the other side of the debate, many scholars argue that the dangers of common ownership on competition are overblown. These scholars conclude that there is no need for intervention.[10] While this common ownership-antitrust debate shows no signs of waning, little attention, if any, has been given to the virtue of common ownership in corporate law. This Article aims to fill that void by showing how common ownership may actually contribute to robust corporate governance, a field in which institutional investors play an important role.[11]

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5. For example, "[t]he Vanguard 500 Index Fund Investor Shares seeks to provide investment results corresponding to the price and yield performance of the S&P 500 Index, its benchmark index, with a high degree of positive correlation." *See* Steven Nickolas, *The 4 Best S&P 500 Index Funds*, INVESTOPEDIA, https://www.investopedia.com/articles/markets/101415/4-best-sp-500-index-funds.asp [https://perma.cc/2U5K-ZU94] (last updated June 25, 2019).

6. As recently observed, passive funds now control "close to 20 per cent" of all U.S. assets, and if they "were to continue their present growth trajectory, they would own all listed stocks by 2030." Renaud de Planta, *The Hidden Dangers of Passive Investing*, FIN. TIMES (May 30, 2017), https://www.ft.com/content/15dd3552-3fad-11e7-82b6-896b95f30f58 [https://perma.cc/Z7BC-GA2L].

7. *See* Elhauge, *supra* note 1, at 1267; *see also* Eric A. Posner et al., *A Proposal to Limit the Anticompetitive Power of Institutional Investors*, 81 ANTITRUST L.J. 669, 671–76 (2017) (summarizing research indicating that common ownership leads to less competition and therefore to higher prices for consumers).

8. Posner et al., *supra* note 7, at 709.

9. Steven Davidoff Solomon, *Rise of Institutional Investors Raises Questions of Collusion*, N.Y. TIMES (Apr. 12, 2016), https://www.nytimes.com/2016/04/13/business/dealbook/rise-of-institutional-investors-raisesquestions-of-collusion.html [https://perma.cc/NF2U-A99E]. This investigation was sparked by José Azar's airline industry study. *See generally* Azar et al., *Anticompetitive Effects*, *supra* note 3 (publishing a draft study).

10. *See generally, e.g.*, Menesh S. Patel, *Common Ownership, Institutional Investors, and Antitrust*, 82 ANTITRUST L.J. 279, 325 (2018) ("[W]hether and the extent to which common ownership actually results in competitive harm in a given market depends on numerous factors . . . ."); *see also generally* Rock & Rubinfeld, *supra* note 1 (challenging the existing scholarship that warns about the dangers of common ownership while still calling for an open discussion on this matter).

11. Louis A. Aguilar, Comm'r, SEC, Institutional Investors: Power and Responsibility, Speech at J. Mack Robinson College of Business, Georgia State University (Apr. 19, 2013), *available at* https://www.sec.gov/news/speech/2013-spch041913laahtm [https://perma.cc/LJ3J-PVWB] (recognizing the increased role of institutional investors over time).

The field of corporate governance has undergone a dramatic change over the last decade. A global trend in modern corporate governance includes targeting companies with *common* features, i.e., companies that are doing the same type of business, in the same industry, and often within the same geographical area. These companies are exposed to similar common risks of criminal investigations and proceedings, and as a result, there is potential for significant collateral harm. These companies are exposed to what I term *macro legal risks.*

These macro legal risks are associated mainly with the healthcare (pharmaceuticals), finance, and energy industries, but all industries that have experienced a renewed wave of targeted compliance enforcement face such risks.[12] The increased enforcement of compliance measures has required companies in the affected industries to take precautionary steps to comply with laws and regulations.[13] These precautionary steps often build off and mirror the steps taken at comparable companies operating within the same industry that have been investigated by and then subsequently settled with

12. JONATHAN KELLERMAN ET AL., PRICEWATERHOUSE COOPERS, STATE OF COMPLIANCE 2014: PHARMACEUTICAL AND LIFE SCIENCES INDUSTRY BRIEF 2 (2014), *available at* https://www.pwc.com/us/en/risk-management/state-of-compliance-survey/assets/pwc-soc-pharma-and-life-sciences.pdf [https://perma.cc/U5FH-ETHP] ("The past few years have witnessed a new wave of global antibribery and anti-corruption enforcement that has put the pharmaceutical and life sciences industry on notice."); Sean J. Griffith, *Corporate Governance in an Era of Compliance*, 57 WM. & MARY L. REV. 2075, 2082 & n.13 (2016) (referring to a survey showing that "compliance officers frequently cite industry-specific regulation as their core compliance concern"); Andrew Ceresney, Div. of Enf't Dir., SEC, FCPA, Disclosure, and Internal Controls Issues Arising in the Pharmaceutical Industry, Remarks at CBI's Pharmaceutical Compliance Congress in Washington D.C. (Mar. 3, 2015), *available at* https://www.sec.gov/news/speech/2015-spch030315ajc.html [https://perma.cc/2ZV3-LGN6] ("But the pharma industry is one on which we have been particularly focused in recent years."); *see also* Brandon L. Garrett, *The Rise of Bank Prosecutions*, 126 YALE L.J.F. 33, 38 (2016) ("It is noteworthy how many financial institutions are now being prosecuted—and with some regularity—such that they are no longer functionally immune from criminal prosecution. In contrast to this recent flurry of activity, very few financial institutions had been prosecuted in decades past. It was almost vanishingly rare for banks to be convicted of crimes . . . ."); Deloitte, *Energy Sector Regulatory Trends for 2015*, WALL ST. J. (Dec. 24, 2014, 12:01 AM), http://deloitte.wsj.com/riskandcompliance/2014/12/24/energy-sector-regulatory-trends-for-2015 [https://perma.cc/EL6E-D2MP] ("The U.S. Commodity Futures Trading Commission (CFTC) strongly asserted its new role within the energy industry. . . . In general, government regulators significantly stepped up their enforcement efforts throughout the industry—forcing energy companies to learn how to operate even more effectively in an environment of increased regulation and regulatory scrutiny.").

13. Martin Lipton et al., *Risk Management and the Board of Directors*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Mar. 20, 2018), https://corpgov.law.harvard.edu/2018/03/20/risk-management-and-the-board-of-directors-5 [https://perma.cc/792M-N576] ("In connection with the above, the board should formally undertake an annual review of the company's risk management system, including a review of board- and committee-level risk oversight policies and procedures, a presentation of 'best practices' to the extent relevant, tailored to focus on the industry or regulatory arena in which the company operates . . . .").

enforcement authorities.[14] Over the last decade, the U.S. Department of Justice ("DOJ"), Securities and Exchange Commission ("SEC"), Environmental Protection Agency ("EPA"), Federal Trade Commission ("FTC"), Internal Revenue Service ("IRS") and other enforcement authorities have increasingly focused on corporate enforcement.[15] These authorities have renewed criminal enforcement actions that have ended with resolutions reached with many companies. The damage to these companies is tremendous and includes massive financial sanctions and other collateral consequences to comparable companies within the industry. Criminal investigations and proceedings have also triggered shareholder suits alleging that directors and officers breached their fiduciary duty by failing to address potential problems.

The upshot here for institutional investors is that enforcement trends now focus on *entire industries*, rather than on companies with specific features. This means that institutional investors who invest heavily in the same industry due to common ownership will have an easier time responding to legal and regulatory challenges. For example, during the last few years, the DOJ and the SEC have used the Foreign Corrupt Practices Act ("FCPA") to focus on particularly risky industries such as energy and healthcare—industries that interact with foreign officials in the sale and promotion of their products.[16] Special attention has been given to common illegal practices conducted in markets with the highest risk for corruption, such as the emerging markets of China, Russia, Latin America, and Africa.[17]

As I explain at length in this Article, when dealing with macro legal risks, common ownership may allow institutional investors to govern companies in which they invest more efficiently.[18] They may do this through voting,[19] or

14. Griffith, *supra* note 12, at 2090–91 (explaining how deferred and non-prosecution agreements "have a strong signaling effect on firms not party to the immediate settlement, pushing them to adopt compliance mechanisms similar to those imposed upon their peers"); *see also* SALLY BERNSTEIN & ANDREA FALCIONE, PRICEWATERHOUSECOOPERS, STATE OF COMPLIANCE 2014 SURVEY: WHAT IT MEANS TO BE A "CHIEF" COMPLIANCE OFFICER: TODAY'S CHALLENGES, TOMORROW'S OPPORTUNITIES 17 (2014), *available at* https://www.pwc.com/us/en/risk-management/state-of-compliance-survey/assets/pwc-state-of-compliance-2014-survey.pdf [https://perma.cc/W728-X3DJ] ("In the event of a compliance failure, government investigators often compare the organization's compliance program to those of similar organizations (in terms of size, complexity, industry, geographic footprint, etc.).").

15. *See infra* Part III.

16. *See* ROBERT W. TARUN, THE FOREIGN CORRUPT PRACTICES ACT HANDBOOK 89–91 (2010); *see also infra* Section III.A (discussing the FCPA).

17. These countries and regions are listed on Transparency International's Corruption Perceptions Index ("CPI") as among the world's most corrupt. *See Corruption Perceptions Index 2016*, TRANSPARENCY INT'L (Jan. 25, 2017), https://www.transparency.org/news/feature/corruption_perceptions_index_2016#table [https://perma.cc/MF9C-C9T4].

18. *See infra* Part V.

19. *See, e.g.*, BLACKROCK, BLACKROCK INVESTMENT STEWARDSHIP ENGAGEMENT PRIORITIES FOR 2018, at 4 (2018) (on file with *Iowa Law Review*) ("We have the same expectation of boards wherever a company faces a material, business-specific risk. We would assess this both through corporate disclosures and direct engagement with independent board members, if necessary.

through engagements with companies' officers and directors.[20] This will lead to minimizing corporate wrongdoing. Since macro legal risks are common to multiple companies, common ownership has the potential to provide institutions with three interrelated merits: (1) enhanced *incentives* for monitoring macro legal risks; (2) *privileged access* to rulemaking and lawmaking that allows institutional investors to recognize legal developments; and (3) *experimental* learning of macro legal risks.

First, macro legal risks, by their very nature, expose entire industries to similar types of risks, as well as expensive and often irreversible damages.[21] Therefore, common ownership creates an *aggregate* exposure for each institutional investor. The level of exposure is directly correlated with the level of common ownership. Assume that Blackrock owns ten percent of a pharma company that paid a penalty of $800 million. Such a situation would cost BlackRock $80 million (ignoring collateral damages). If BlackRock's level of common ownership is low and it owns ten percent in only one other pharma company, BlackRock is only exposed to an additional $80 million, leaving it with a total exposure of $160 million. Alternatively, assume BlackRock holds similar shares in ten pharma companies instead of two; it now has an exposure of $800 million instead of $160 million. In the former case, Blackrock was

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Where we have concerns that the board is not dealing with a material risk appropriately, as with any other governance issue, we may signal that concern through our vote, most likely by voting against the re-election of certain directors we deem most responsible for board process and risk oversight."); *see also* Henry Cutter, *The Morning Risk Report: Antibribery Program Is Seen as Model*, WALL ST. J. (Mar. 5, 2018, 7:34 AM), https://blogs.wsj.com/riskandcompliance/2018/03/05/the-morning-risk-report-antibribery-program-is-seen-as-model [https://perma.cc/9SGJ-U46R] ("BlackRock said it can't dictate what a company can do, but warned it generally has the ability to vote against individual directors or in favor of shareholder proposals, the WSJ reports."); Carol J. Loomis, *BlackRock: The $4.3 Trillion Force*, FORTUNE (July 7, 2014), http://fortune.com/2014/07/07/blackrock-larry-fink [https://perma.cc/9GRA-RRB7] (explaining how, in a "protest vote" against "the board's most prominent members" following Walmart's well-known FCPA scandal in Mexico, "BlackRock voted . . . against four Wal-Mart director nominees of particular note: board chairman Rob Walton and his brother, Jim, and former Wal-Mart CEOs Mike Duke and Lee Scott").

20. In their recent article, Matthew J. Mallow and Jasmin Sethi, both senior directors at BlackRock, describe many interrelated forms of engagement, "including: holding direct conversations with companies, regulators, and issue experts; conducting educational outreach with the market; collaborating with other investors, companies, and advocates; convening summits to identify tipping points; soliciting shareholder proposals; and sponsoring academic and other intellectual analysis on the issues to increase market participant awareness." Matthew J. Mallow & Jasmin Sethi, *Engagement: The Missing Middle Approach in the Bebchuck–Strine Debate*, 12 N.Y.U. J.L. & BUS. 385, 393 (2016); *see also* ROB BAUER & MICHAEL VIEHS, DEUTSCHE BANK GRP., CORPORATE ENGAGEMENT BY INSTITUTIONAL SHAREHOLDERS 5 (2012), *available at* https://www.db.com/cr/en/docs/DB_Climate_Change_Advisors_-_Corporate_Engagement_Studie_(en).pdf [https://perma.cc/C2S4-C5KB] ("Nowadays, many institutions have special engagement departments that deal with the communication of concerns and complaints to portfolio firms.").

21. Macro legal risks expose companies to huge damages. Beyond high costs of investigation and settlement, such risks include reputational damages, suspension and debarment from governmental projects, and others. *See infra* Part V.

likely to remain passive because it experienced relatively low exposure. In the latter case, Blackrock is more likely to be active, as their exposure is substantially higher. In other words, higher levels of common ownership create higher exposure to macro legal risk, and thus are more likely to increase incentives of institutional investors to be aware of legal risks and respond to them by better monitoring the level of compliance of companies in which they invest.

Furthermore, given that macro legal risks involve features that are common to multiple companies in the same industry and use similar techniques and strategies, common ownership allows institutional investors to use a one-size-fits-all approach, rather than a firm-specific approach, to corporate governance and corporate compliance. Institutional investors do not need to have the information or resources necessary to tailor different arrangements to the particular features of individual companies. Instead, they only need to be able to identify macro trends and patterns, rather than firm-specific differences.[22] Accordingly, institutional investors incur relatively low costs of identifying and responding to macro legal risks, and their incentives to monitor companies are likely to increase.[23] This allows institutional investors to spread the costs of identifying and responding to the macro legal risks over a large number of companies.[24] As I will discuss later in the Article, this makes the familiar "passivity story,"[25] describing the reluctance of institutional investors to engage in corporate governance issues,[26] less valid.

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22. *See infra* Part IV.

23. It is interesting to note that the fact that the degree of portfolio concentration of institutional investors is likely to increase the level of their engagement has been already recognized in Serdar Çelik & Mats Isaksson, *Institutional Investors and Ownership Engagement*, 2013 OECD J. 93, 107 (2014) ("The implications for ownership engagement are simply arithmetic. The costs of exercising the same quality of informed and engaged ownership in 10 000 [sic] companies is obviously much higher than if you monitor only a handful. This is why institutions with highly diversified equity portfolios abstain from ownership engagement."). Importantly, Çelik and Isaksson discuss concentration as absolute numbers of companies within the portfolio. *Id.* This ignores the benefits of common ownership, which recognizes that when an institutional investor invests in companies in the same industry, their costs of engagement with one company are similar to their costs of engagement with all the companies in the industry combined. Therefore, common ownership is likely to enhance institutions engagement.

24. *See* Peter Iliev & Michelle Lowry, *Are Mutual Funds Active Voters?*, 28 REV. FIN. STUD. 446, 450 (2015); Marcel Kahan & Edward B. Rock, *Hedge Funds in Corporate Governance and Corporate Control*, 155 U. PA. L. REV. 1021, 1048 (2007).

25. A term coined in Bernard S. Black, *Shareholder Passivity Reexamined*, 89 MICH. L. REV. 520, 522 (1990). This term refers to the "[c]ollective action problems, which arise because each shareholder owns a small fraction of a company's stock, [that] explain why shareholders can't be expected to care." *Id.* Therefore, "shareholders don't care much about voting except in extreme cases and never will." *Id.*

26. *See, e.g.*, Çelik & Isaksson, *supra* note 23, at 105–08 (detailing options of engagement available to institutional investors depending on their business model, and why institutional investors are reluctant to engage in corporate governance issues when they do not coincide with their business model).

In the same vein, common ownership may help reduce institutional concerns regarding the free-rider problem.[27]

The second merit of common ownership is *privileged access* to the process of making law and regulation. Since the 1980s, institutional ownership in public companies has increased, reaching 67 percent by the end of 2010.[28] It is no surprise that institutional investors have become increasingly involved in discussions held by Congress and the SEC, engaging in ongoing dialogue with these authorities.[29] As such, institutional investors are able to identify upcoming trends and patterns in law and regulation, inform companies in which they invest in about potential exposure, and require them to implement checks and controls to comply with upcoming trends and patterns. Limiting common ownership may unintentionally limit an institution's ability to enjoy the benefits of access to policymaking.

Regarding the third merit of common ownership, *experimental learning of macro legal risks*, common ownership has the potential to improve institutional investors' understanding of market conditions, changes in interpretation of existing statutes, strategic decisions of enforcement authorities, and more. Large investors such as BlackRock, Fidelity, Vanguard, Capital Research, Capital World Investors, and others have significant stakes in many American companies operating within the same industry.[30] Macro legal risks are not unique to a single company but are common to many companies that operate within the same industry. Once the DOJ or the SEC commences an investigation against a certain company in which institutional investors invest (the "infected" company), the investigation becomes public through official reports. Investors with a large stake in the infected company should become aware of the investigation and the nature of the allegedly illegal corporate activity and take appropriate steps to comply with laws and regulations and minimize macro legal risks.

Here, common ownership provides institutional investors with accumulated experience that allows them to capitalize on accrued knowledge that an individual director who serves in only one company (or even a few companies) might overlook. Just as enforcement authorities such as the DOJ, the SEC, and the IRS share information about illegal schemes,[31] in this way institutional investors can use common ownership to enhance information

27. *See infra* notes 205–07 and accompanying text.

28. MATTEO TONELLO & STEPHAN RABIMOV, CONFERENCE BD., THE 2010 INSTITUTIONAL INVESTMENT REPORT: TRENDS IN ASSET ALLOCATION AND PORTFOLIO COMPOSITION 27 & tbl.13 (2010), *available at* http://ssrn.com/abstract=1707512 [https://perma.cc/F7NN-HMEX]; *see also* Stuart L. Gillan & Laura T. Starks, *The Evolution of Shareholder Activism in the United States*, 19 J. APPLIED CORP. FIN. 55, 57 fig.1 (2007); Marcel Kahan & Edward Rock, *Embattled CEOs*, 88 TEX. L. REV. 987, 995–97 (2010).

29. *See infra* Part IV.

30. Azar et al., *supra* note 2, at 45 & tbl.1. *See generally* Azar et al., *Anticompetitive Effects*, *supra* note 3.

31. *See infra* note 301 and accompanying text.

flow regarding lessons learned from investigations and proceedings. Common ownership creates a network of interlocking companies in which institutional investors may acquire expertise and experience, which they can then implement in other companies. Thus, common ownership has the potential to enhance efficient learning processes and information flow among companies, and consequently improve corporate governance and compliance.

Common ownership may also encourage institutional investors to become more active and to act as stewards in the interest of their beneficiaries. As mentioned above,[32] evolving scholarship argues against the antitrust threat caused by institutional "investors with substantial horizontal shareholdings that *in aggregate* lessen competition."[33] In fact, *aggregate ownership* is actually likely to improve institutional investors' incentives and ability to monitor companies in which they invest when dealing with macro legal risks that have become prevalent during recent years.

This Article reaches two major implications. First, potential virtues of common ownership in corporate compliance that so far have been overlooked by policymakers and commentators should be taken into account when considering regulatory intervention based on concerns of anticompetitive effects of institutional investors' common ownership. Second, this Article suggests the need to start looking at another aspect of corporate governance—corporate compliance—in which institutional investors can apply more generic models, in relatively low costs, in order to ensure that firms in which they invest comply with laws and regulations that cover entire sectors and industries.

This Article will proceed in five parts. Part II provides necessary background on the Common Ownership debate. Part III explains how the corporate legal landscape has changed over the last decade and how there is an increasing number of macro-level risks today, including recent developments in anti-corruption, fraud against the government, anti-money laundering, antitrust and environmental protection. Part IV explores the nature of macro legal risks and concludes that they are relatively observable and verifiable. This fact is likely to improve institutional investors' incentives to oversee companies. Part V presents a new common ownership theory and shows why and how common ownership structure has the potential to enhance corporate governance and compliance. Part V will describe the three interrelated merits of common ownership: (1) enhanced *incentives* of institutional investors for monitoring macro legal risks; (2) *privileged access* of investors to rulemaking and lawmaking that allows institutional investors to recognize legal developments; and (3) *experimental* learning of macro legal risks. Part V importantly includes examples of institutional investors'

32. *See supra* notes 7–9 and accompanying text.

33. Elhauge, *supra* note 1, at 1283 n.77 (emphasis added).

engagement with companies regarding macro legal risks, as well as examples of how institutional investors engage in dialogue with regulators in an attempt to get involved with the rulemaking process. Part VI addresses a potential objection to the common ownership approach, which argues that common ownership structure may not be needed to enhance monitoring because of the prevalent structure of interlocking Boards and because of services provided by professionals. As will be explained, although the structure of interlocking Boards can contribute to directors' abilities to advise companies on industry-oriented legal risks that may be common to multiple companies in which they serve as directors, the impact of interlocking Boards may be limited because of the limit on the number of boards a director can sit on, as well as the question of how independent a board member can truly be. As to professionals, their capacity to advise companies does not necessarily translate into a strong ability to monitor companies and enhance their compliance with laws. Finally, Part VII outlines potential implications of the thesis offered in this Article. The Article will then end with a short conclusion.

II. THE COMMON OWNERSHIP DEBATE

Common ownership refers to a corporate structure in which the same institutional investors are the major shareholders in rival companies operating within the same industry,[34] and has dramatically increased in the last 30 years.[35] Common ownership has been the object of scholarly debate and analysis since the 1980s and the argument has focused on whether common ownership has anticompetitive effects,[36] rather than on its effect on corporate compliance. In their recent study, Erik P. Gilje, Todd A. Gormley, and Doron Levit found that this growth can be attributed to index investing,[37] a strategy that uses the wide range of market indices that can be tracked as performance benchmarks. If an institutional investor invests in an index that includes competitor companies within the same industry, it will naturally lead to a higher rate of common ownership since by investing in the index, the institutional investor invests in all of the companies in the index. For example, an institutional investor who invests in the S&P 500 invests in all of the companies on the index, including those that operate in the same industry,

34. *Id.* at 1267–68.

35. Gilje et al., *supra* note 4, at 19.

36. For classic works see generally, Timothy F. Bresnahan & Steven C. Salop, *Quantifying the Competitive Effects of Production Joint Ventures*, 4 INT'L J. INDUS. ORG. 155 (1986); and Robert J. Reynolds & Bruce R. Snapp, *The Competitive Effects of Partial Equity Interests and Joint Ventures*, 4 INT'L J. INDUS. ORG. 141 (1986) (noting classic works). For further review of the relevant literature, see generally Gilje et al., *supra* note 4 (reviewing relevant literature).

37. Gilje et al., *supra* note 4, at 4. For similar preliminary findings, see generally Jarrad Harford et al., *Institutional Cross-Holdings and Their Effect on Acquisition Decisions*, 99 J. FIN. ECON. 27 (2011) (noting similar preliminary findings).

such as American Airlines, Alaskan Air Group, United Continental Holdings, and Delta Airlines, which all operate in the airline industry.[38]

Along with the rise of common ownership, a dispute has emerged as to whether legal and regulatory steps should be taken to limit this structure's potentially adverse influence on competition. Setting off this dispute were two studies conducted by José Azar and his colleagues. In one study, José Azar, Martin C. Schmalz, and Isabel Tecu focus on the airline industry, showing that top shareholders of one airline company hold major stakes in other airline companies,[39] and that U.S. airline ticket prices are 10–12 percent higher because of this instance of common ownership.[40] A related study performed by José Azar, Sahil Raina, and Martin Schmalz provides evidence that suggests a causal link between common ownership within the banking industry and higher fees for banking accounts.[41]

These studies incited an intense debate over the effects of common ownership on competitiveness. Einer Elhauge and others have argued that common ownership violates antitrust laws. Elhauge argued that common ownership can explain why corporate executives are compensated for industry performance rather than individual corporate performance alone; why corporations have not used recent high profits to expand output and capital projects and instead have retained trillions of dollars in cash and spent other profits on dividends and high executive compensation; and why economic inequality has risen in recent decades.[42] Following Elhauge, Eric A. Posner, Fiona M. Scott Morton, and E. Glen Weyl have proposed legal and regulatory changes in order to limit common ownership.[43] Miguel Antón, Florian Ederer, Mireia Giné, and Martin C. Schmalz conducted a study showing that increasing levels of common ownership within industries leads to reduced pay-for-performance sensitivity.[44] According to their theoretical explanation, because the revenue model of asset managers (such as BlackRock and Vanguard) is based on the percentage of assets under

38. *Airline Stocks in the S&P 500 Index*, INVESTSNIPS, http://investsnips.com/airline-stocks-in-the-sp-500-index [https://perma.cc/5GPK-BBER].

39. *See generally* Azar et al., *supra* note 3 (researching the Airline Industry).

40. *Id.* at 1518.

41. Azar et al., *supra* note 2 (researching the Banking Industry). This study found that a one standard deviation increase in the generalized HHI—the standard measure of concentration —leads to about an 11 percent increase in fees. *Id.* at 27.

42. Elhauge, *supra* note 1, at 1278–301.

43. Posner et al., *supra* note 7, at 678 (arguing that the FTC and the DOJ should institute a public enforcement policy of the Clayton Act against institutional investors that would limit their holdings in a single industry).

44. *See generally* Miguel Antón et al., *Common Ownership, Competition, and Top Management Incentives* (European Corp. Governance Inst., Working Paper No. 511, 2018), *available at* https://ecgi.global/sites/default/files/working_papers/documents/finalantonederergineschmalz.pdf [https://perma.cc/QK7U-WKMM] (showing that increasing levels of common ownership within industries leads to reduced pay-for-performance sensitivity).

management, these institutions aim to maximize the value of their entire stock portfolio. Thus, asset managers would prefer to design executive compensation in a way that weakens managers' incentives to compete against their industry rivals and limit fierce competition between portfolio firms.[45]

The studies described above have attracted strong scholarly critique. Edward B. Rock and Daniel L. Rubinfeld have questioned the ability of institutional investors to cause managers to reduce competition or the incentives of managers to align with investors' anticompetitive interests,[46] and conclude that there is no antitrust problem to be addressed.[47] Similar questions have been raised by Daniel P. O'Brien and Keith Waehrer who "conclude that both researchers and policy authorities are getting well ahead of themselves in calling for and implementing policy changes based on this research."[48] The conclusions reached by Antón et al. regarding the adverse effect of common ownership on executive compensation have been challenged as well.[49] In a recent paper, Heung Jin Kwon shows that higher common ownership of natural competitors is, in fact, associated with greater use of relative performance evaluation in executive compensation contracts, i.e., increased pay-for-performance sensitivity.[50] Finally, BlackRock also released a ViewPoint responding to this critique of common ownership[51] and

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45. *Id.* at 2. This study also uses the airline industry to prove the general point that common ownership can reduce competition among competitors. None of the top owners of Virgin America (Richard Branson, Virgin Group and a hedge fund), own significant stakes in competitors. In contrast, the top owners of other airlines are institutional investors who own top stakes in other competitors. Richard Branson would benefit from stealing market share of competitors, but an institutional investor who invests in American Airlines, Delta, and United, would not. *Id.* at 2, 34–35 tbl.1.

46. *See generally* Rock & Rubinfeld, *supra* note 1 (raising doubts regarding empirical methods used in studies of Azar and his co-authors).

47. *Id.* at 24, 36–37.

48. Daniel P. O'Brien & Keith Waehrer, The Competitive Effects of Common Ownership: We Know Less than We Think 2 (Feb. 22, 2017) (unpublished manuscript), *available at* https://papers.ssrn.com/sol3/papers2.cfm?abstract_id=2922677 [https://perma.cc/L9VH-3VG4].

49. *See generally* Antón et al., *supra* note 44 (demonstrating increasing levels of common ownership).

50. *See* Heung Jin Kwon, Executive Compensation Under Common Ownership 2 (Nov. 29, 2016) (unpublished manuscript), *available at* http://www.fmaconferences.org/Boston/ExecutiveCompensationunderCommonOwnership.pdf [https://perma.cc/GTQ5-H4CW] ("[T]he results . . . indicate that [relative performance evaluation] is *positively* associated with common ownership.").

51. BARBARA NOVICK ET AL., BLACKROCK, INDEX INVESTING AND COMMON OWNERSHIP THEORIES 6 (2017), *available at* https://www.blackrock.com/corporate/en-tw/literature/whitepaper/viewpoint-index-investing-and-common-ownership-theories-eng-march.pdf [https://perma.cc/Y6BA-TNH6] ("[S]ome recent literature in economics has examined whether common ownership can harm consumers, for example, by resulting in higher prices in a specific sector. This research is preliminary, and is in the process of being scrutinized by other academics . . . . While some of the papers assert statistical findings, they do not provide a plausible causal link between common ownership and higher prices for consumers." (footnotes omitted)).

emphasizing the attractiveness of index investing, a trend that (as noted above) has largely contributed to the common ownership evolution.[52]

This Article does not aim to take part in the common ownership-antitrust debate. Instead, it discusses the implications of the common ownership structure more broadly and examines its potential merits in anticipation of possible legal and regulatory reforms. This Article discusses how common ownership may enhance corporate governance in today's corporate landscape, a landscape that increasingly exposes corporations to macro legal risks. Part III of this Article will outline this change in landscape through the examples of anti-corruption, antitrust, environmental violations, and fraud against the government.

III. The Changing Landscape of Corporate Law—A Survey of Macro Legal Risks

Over the last decade, corporate enforcement has undergone a significant change. Today, more than ever before, companies are subject to legal risks that can be characterized as macro legal risks. Rather than trying to execute enforcement actions against a single corporate wrongdoing, the DOJ and other enforcement agencies invest tremendous resources in trying to uproot widespread phenomena such as corruption, antitrust, environmental violations, and fraud against the government. These efforts have led to many recent successes for enforcement agencies.

Part III will provide a brief overview of this recent enforcement trend. This trend enhances the ability of institutional investors to be effective in their corporate governance, as the enforcement levied against one firm in which they have invested in should be the same enforcement to which the rest of their investment companies are subjected. This overview sets the stage for this Article's claim that common ownership, and the enhanced corporate governance that comes about as a result, is a solution for a more effective response to macro legal risks.

A. *Foreign Corruption Practices Act*

Corruption is an excellent example of an increasing macro legal risk that institutional investors with holdings in line with common ownership can better address through standard corporate governance and compliance applied to companies in which they invest. In 1977, Congress passed the FCPA to fight corruption in international business transactions.[53] However, until

52. *Id.* at 1 ("Index funds . . . have become a powerful force for the democratization of investment. Since the first index funds were launched in the 1970s, their growth, particularly during the last decade, has made such funds and index investing more generally a cornerstone of investment practice." (footnote omitted)).

53. Foreign Corrupt Practices Act of 1977, Pub. L. No. 95-213, 91 Stat. 1494, 1494 ("[T]o make it unlawful for an issuer of securities registered pursuant to section 12 of [the Securities Exchange Act of 1934] or an issuer required to file reports pursuant to section 15(d) of such Act

1998, FCPA investigations and prosecutions were rare.[54] Aggressive enforcement of FCPA cases with larger penalties began in earnest in 2005 and ever since, "the number of FCPA enforcement proceedings and the amount in financial penalties [for FCPA violations] have sky-rocketed."[55] 70 percent of DOJ- and SEC-initiated FCPA cases since 1977 were brought during the eight-year-period from 2005–2013.[56] Large fines have been paid by corporations to settle FCPA cases, including global engineering firm Kellogg Brown & Root ("KBR"), which paid $579 million to the DOJ and SEC in 2009 to resolve FCPA offenses.[57]

Enforcement efforts and actions have been accompanied by lawmakers' campaigns. For example, in 2007, Mark F. Mendelsohn, Deputy Chief of the Fraud Section of the DOJ's Criminal Division, opened the American Conference Institute ("ACI") FCPA Conference by emphasizing a renewed focus on implementing measures to combat foreign bribery.[58]

In September 2008, Mendelsohn reiterated this point when speaking at an American Bar Association panel on foreign bribery about the dramatic

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to make certain payments to foreign officials and other foreign persons, to require such issuers to maintain accurate records, and for other purposes.").

54. For historical background of FCPA enforcement until the 2000s, see, e.g., Barbara Black, *The SEC and the Foreign Corrupt Practices Act: Fighting Global Corruption Is* Not *Part of the SEC's Mission*, 73 OHIO ST. L.J. 1093, 1096–107 (2012); see also Brandon L. Garrett, *Globalized Corporate Prosecutions*, 97 VA. L. REV. 1775, 1829 (2011).

55. Roger M. Witten et al., *Prescriptions for Compliance with the Foreign Corrupt Practices Act: Identifying Bribery Risks and Implementing Anti-Bribery Controls in Pharmaceutical and Life Sciences Companies*, 64 BUS. LAW. 691, 691–92 (2009); *see also* Joel M. Cohen et al., *Under the FCPA, Who Is a Foreign Official Anyway?*, 63 BUS. LAW. 1243, 1247 (2008) ("As of February 2005, U.S. regulators had been involved in [35] foreign bribery prosecutions and [17] additional active investigations. By July 2007, these numbers had risen to [67] and [60], respectively. . . . In April 2007, Baker Hughes Service International, Inc. . . . was penalized $44 million, 'the largest monetary sanction ever imposed in an FCPA case.'" (footnotes omitted)).

56. SEARLE CIVIL JUSTICE INST., LAW & ECON. CTR. OF GEORGE MASON UNIV. SCH. OF LAW, THE FOREIGN CORRUPT PRACTICES ACT: ECONOMIC IMPACT ON TARGETED FIRMS 1 (2014), *available at* http://masonlec.org/site/rte_uploads/files/FCPA%20II%20Final%20%286.4%29.pdf [https://perma.cc/RW7J-TPH6].

57. Press Release, SEC, SEC Charges KBR and Halliburton for FCPA Violations (Feb. 11, 2009), *available at* http://www.sec.gov/news/press/2009/2009-23.htm [https://perma.cc/B5SJ-96KT]; Press Release, U.S. Dep't of Justice, Kellogg Brown & Root LLC Pleads Guilty to Foreign Bribery Charges and Agrees to Pay $402 Million Criminal Fine (Feb. 11, 2009), *available at* http://www.justice.gov/opa/pr/2009/February/09-crm-112.html [https://perma.cc/BL7P-3ZHE]. To gain an idea of the scope of DOJ and SEC investigations into FCPA cases, see *2007 Year-End FCPA Update*, GIBSON DUNN (Jan. 4, 2008), https://www.gibsondunn.com/2007-year-end-fcpa-update [https://perma.cc/5TD3-CXJ9]. Gibson Dunn lists dozens of FCPA investigations in just 2007 alone. *Id.*

58. *2007 Year-End FCPA Update*, *supra* note 57. Fredric D. Firestone, an Associate Director in the SEC's Division of Enforcement followed Mendelsohn's words by saying "ditto from the SEC." *Id.*

increase in the number of FCPA cases.[59] In November 2009, the head of the DOJ Criminal Division, Lanny Breuer, affirmed this trend, warning that the DOJ plans to focus on prosecuting pharma companies that "try to bribe foreign officials for preferential treatment of their products,"[60] noting in November 2010 that "FCPA enforcement is stronger than it's ever been—and getting stronger."[61]

Among the reasons for the trend described above is the amendment of the FCPA in 1998 to comply with the Organization of Economic Co-operation and Development ("OECD") Convention,[62] as well as the adoption of the Convention Against Corruption by the United Nations in 2003.[63] During this period, the DOJ consistently viewed FCPA prosecutions as one of its highest priorities. In 2008, the Federal Bureau of Investigation ("FBI") created a unit dedicated to FCPA investigations;[64] and in 2010, the SEC also formed a specialized unit within its enforcement division to focus on these cases.[65] Finally, the DOJ published a new FCPA Corporate Enforcement Policy in November 2017.[66] This policy was designed to encourage companies to voluntarily disclose misconduct and cooperate with enforcement authorities,

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59. *Mendelsohn Says Criminal Bribery Prosecutions Doubled in 2007*, 22 CORP. CRIME REP. 36 (2008), *available at* https://www.corporatecrimereporter.com/mendelsohn091608.htm [https://perma.cc/BN5G-7UC9].

60. Jeremy Pelofsky, *Justice Dept Warns Drug Companies on Corruption*, REUTERS (Nov. 12, 2009, 12:54 PM), http://www.reuters.com/article/us-corruption-idUSTRE5AB4AT20091112 [https://perma.cc/88UW-QR9F]; Dionne Searcey, *Breuer Sends FCPA Warning to Big Pharma (and its Executives)*, WALL ST. J. (Nov. 13, 2009, 4:47 PM), https://blogs.wsj.com/law/2009/11/13/breuer-sends-fcpa-warning-to-big-pharma-and-its-executives [https://perma.cc/BS4H-EV2M].

61. Lanny A. Breuer, Assistant Attorney Gen., U.S. Dep't of Justice, Address at the 24th National Conference on the Foreign Corrupt Practices Act (Nov. 16, 2010), *available at* www.justice.gov/criminal/pr/speeches/2010/crm-speech-101116.html [https://perma.cc/R6DR-8H7U] ("[W]e are in a new era of FCPA enforcement; and we are here to stay.").

62. *See generally* ANDREA BONIME-BLANC & MARK BRZEZINSKI, CONFERENCE BD., A NEW ERA IN GLOBAL ANTI-CORRUPTION: GOVERNMENTS GET SERIOUS ABOUT ENFORCEMENT (2010), *available at* https://gecrisk.com/wp-content/uploads/2013/03/ABonimeBlanc-MBrzezinski-New-Era-Global-Anti-Corruption-TCB-2009.pdf [https://perma.cc/D2BX-F834] (facilitating international collaboration and joint investigations of several countries).

63. *Id.* at 3 (effective date of U.N. Convention was in 2005); *see also* Marika Maris & Erika Singer, *Foreign Corrupt Practices Act*, 43 AM. CRIM. L. REV. 575, 594–96 (2006) (signing of Convention was in 2003).

64. *What We Investigate: Public Corruption*, FED. BUREAU INVESTIGATION, https://www.fbi.gov/investigate/public-corruption [https://perma.cc/AV5H-8DF6].

65. Andrew Ceresney, Co-Dir. of Div. of Enf't, SEC, Keynote Address at the International Conference on the Foreign Corrupt Practices Act (Nov. 19, 2013), *available at* https://www.sec.gov/news/speech/2013-spch111913ac [https://perma.cc/HL9V-27EB].

66. U.S. DEP'T OF JUSTICE, *FCPA Corporate Enforcement Policy*, *in* THE JUSTICE MANUAL 9-47.120, *available at* https://www.justice.gov/criminal-fraud/file/838416/download [https://perma.cc/B2P6-NDCT] (last updated Mar. 2019); Rod J. Rosenstein, Deputy Attorney Gen., U.S. Dep't of Justice, Remarks at the 34th International Conference on the Foreign Corrupt Practices Act (Nov. 29, 2017), *available at* https://www.justice.gov/opa/speech/deputy-attorney-general-rosenstein-delivers-remarks-34th-international-conference-foreign [https://perma.cc/Y4PA-QLQV].

signaling that the Trump administration will continue to emphasize FCPA enforcement.

Most relevant to this Article is the fact that FCPA cases have common features and both the DOJ and the SEC frequently focus on certain areas like Latin America, particularly Brazil, Mexico, Venezuela, and Argentina —countries that are perceived as having a high incidence of corruption. The DOJ and the SEC also focus on *certain industries* in which companies interact with foreign officials in the sale and promotion of their products, and foreign bribery is most likely to occur (for example, the defense, telecommunications, oil and oil-services, and healthcare industries). U.S. authorities have placed special emphasis on the healthcare industry, with actions against Novartis,[67] AstraZeneca,[68] Teva,[69] GlaxoSmithKline,[70] and other pharma companies.[71] Similar importance has been given to the energy (oil-and-gas) industry with actions against Baker Hughes,[72] as well as the six companies that were part of the famous "Panalpina affair," in which the DOJ and the SEC settled with Pride International Inc., Royal Dutch Shell PLC, Tidewater Inc., Transocean Inc., GlobalSantaFe Corp., and Noble Corp.—all linked to the Swiss logistics company Panalpina, who admitted to engaging in foreign bribery.[73]

B. *FALSE CLAIMS ACT*

In recent years, the False Claims Act ("FCA")[74] has become a major weapon in combating corporate fraud against the U.S. government, and a

67. Novartis AG, Exchange Act Release No. 77431, 113 SEC Docket 4005, 2016 WL 1130574, at *1 (Mar. 23, 2016) (imposing a cease-and-desist order).

68. AstraZeneca PLC, Exchange Act Release No. 78730, 114 SEC Docket 5946, 2016 WL 4524883, at *1 (Aug. 30, 2016) (imposing cease-and-desist order).

69. Press Release, U.S. Dep't of Justice, Teva Pharmaceutical Industries Ltd. Agrees to Pay More Than $283 Million to Resolve Foreign Corrupt Practices Act Charges (Dec. 22, 2016), *available at* https://www.justice.gov/opa/pr/teva-pharmaceutical-industries-ltd-agrees-pay-more-283-million-resolve-foreign-corrupt [https://perma.cc/2X9A-BH7C].

70. GlaxoSmithKline PLC, Exchange Act Release No. 79005, 115 SEC Docket 819, 2016 WL 5571623, at *1 (Sept. 30, 2016) (imposing remedial sanctions and a cease-and-desist order).

71. *See generally* Andrew Ceresney, Dir. of Div. of Enf't, SEC, FCPA, Disclosure, and Internal Controls Issues Arising in the Pharmaceutical Industry, Remarks at CBI's Pharmaceutical Compliance Congress in Washington, D.C. (Mar. 3, 2015), *available at* https://www.sec.gov/news/speech/2015-spch030315ajc.html [https://perma.cc/VJ8X-NYRP] ("[T]he pharma industry is one on which we have been particularly focused in recent years.").

72. Plea Agreement at 1–2, United States v. Baker Hughes Servs. Int'l, Inc., No. 4:07-cr-00129 (S.D. Tex. 2007), *available at* https://www.justice.gov/sites/default/files/criminal-fraud/legacy/2011/02/16/04-11-07bakerhughes-plea.pdf [https://perma.cc/FT6D-TEVA].

73. Samuel Rubenfeld & Joseph Palazzolo, *Panalpina Settlements Announced, with $236.5 Million in Penalties*, WALL ST. J. (Nov. 4, 2010, 3:28 PM), https://blogs.wsj.com/corruption-currents/2010/11/04/panalpina-settlements-announced-with-2365-million-in-penalties/?ns=prod/accounts-wsj [https://perma.cc/DH6C-C2DK].

74. False Claims Act, 31 U.S.C. §§ 3729–3733 (2012).

great example of a macro legal risk affecting the healthcare industry.[75] The Act prohibits any person or organization from defrauding the government on the material terms of its receipt of government money or certification. The FCA has been actively used in recent years, and in 2017 alone, the DOJ recovered over $3.7 billion from FCA cases.[76]

While the FCA is applicable and enforceable across industries, in the past five years it has been particularly heavily enforced against the healthcare (pharmaceuticals) industry, the financial services industry, and the energy industry. In 2017, $2.4 billion of the $3.7 billion recovered in settlements and judgements was from the healthcare industry.[77] This is by no means out of the ordinary, and the DOJ noted that "[t]his is the eighth consecutive year that the department's civil health care fraud settlements and judgments have exceeded $2 billion."[78]

For example, in 2009 the pharmaceutical giant Pfizer agreed to pay $2.3 billion to settle FCA civil and criminal allegations after Pfizer was accused of promoting the sale of certain drugs that the U.S. Food and Drug Administration ("FDA") refused to approve due to safety concerns.[79] This was considered to be a landmark settlement as it was, at the time, the largest healthcare fraud settlement in the DOJ's history.[80] In emphasizing the magnitude of the penalties FCA infringers should expect to face, Assistant Attorney General Tony West said, "This civil settlement and plea agreement by Pfizer represent[s] yet another example of what penalties will be faced when a pharmaceutical company puts profits ahead of patient welfare."[81] In the same year, global pharma company Eli Lilly paid $1.4 billion under the FCA to resolve a DOJ claim that it had violated the FCA by illegally promoting one of its drugs for non-FDA uses, such as for treating dementia, aggression,

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75. As "Benjamin C. Mizer, head of the Justice Department's Civil Division announced" in December 2016, "Congress amended the False Claims Act 30 years ago to give the government a more effective tool against false and fraudulent claims against federal programs . . . . [and a]n astonishing 60 percent of those recoveries were obtained in the last eight years." Press Release, U.S. Dep't of Justice, Justice Department Recovers Over $4.7 Billion from False Claims Act Cases in Fiscal Year 2016 (Dec. 14, 2016), *available at* https://www.justice.gov/opa/pr/justice-department-recovers-over-47-billion-false-claims-act-cases-fiscal-year-2016 [https://perma.cc/4XFM-T5J6].

76. Press Release, U.S. Dep't of Justice, Justice Department Recovers Over $3.7 Billion from False Claims Act Cases in Fiscal Year 2017 (Dec. 21, 2017), *available at* https://www.justice.gov/opa/pr/justice-department-recovers-over-37-billion-false-claims-act-cases-fiscal-year-2017 [https://perma.cc/ZJW2-6S5A].

77. *Id.*

78. *Id.*

79. Press Release, U.S. Dep't of Justice, Justice Department Announces Largest Health Care Fraud Settlement in Its History (Sept. 2, 2009), *available at* https://www.justice.gov/opa/pr/justice-department-announces-largest-health-care-fraud-settlement-its-history [https://perma.cc/7NQK-WPSC].

80. *Id.*

81. *Id.*

and generalized sleep disorder.[82] Healthcare has continued to be the focus of the DOJ and in 2012, Abbott Laboratories paid $1.5 billion to resolve criminal and civil FCA investigations arising from its unlawful promotion of one of its drugs for non-FDA approved uses.[83] Finally, in 2013, Johnson & Johnson ("J&J") agreed to pay $2.2 billion to settle FCA allegations that J&J promoted drugs for uses not approved as safe and effective by the FDA.[84] Pfizer, Eli Lilly, and J&J provide examples of the scrutiny and penalties that similarly situated companies in the healthcare industry are facing.

The healthcare industry is not the only industry that has been the subject of FCA enforcement in recent years. The financial services industry has also been the target of heavy enforcement and many companies have been penalized with heavy fines relating to violations of the FCA, especially following actions committed leading up to and during the 2008 economic crisis. Often, the FCA violation is combined with a Financial Institutions Reform, Recovery, and Enforcement Act of 1989 ("FIRREA") violation. In September 2017, Allied Home Mortgage was fined $296,298,325, and Allied's president and CEO, Jim Hodge, was personally fined $25,340,496 for violating the FCA and the FIRREA.[85] This was due to years of fraud and misconduct while participating in the Federal Housing Administration ("FHA") mortgage insurance program. Specifically, "[Allied] abused the FHA mortgage insurance program by falsely certifying that thousands of high risk, low quality loans were eligible for FHA insurance and then submitting insurance claims to FHA when any of those loans defaulted."[86]

Only a month earlier, PHH Mortgage Corp agreed to pay the United States $74,453,802 in a settlement to resolve alleged FCA violations.[87] It was

82. Press Release, U.S. Dep't of Justice, Eli Lilly and Company Agrees to Pay $1.415 Billion to Resolve Allegationsof [sic] Off-Label Promotion of Zyprexa (Jan. 15, 2009), *available at* https://www.justice.gov/opa/pr/eli-lilly-and-company-agrees-pay-1415-billion-resolve-allegations-label-promotion-zyprexa [https://perma.cc/A74X-B4CU].

83. Press Release, U.S. Dep't of Justice, Abbott Labs to Pay $1.5 Billion to Resolve Criminal & Civil Investigations of Off-label Promotion of Depakote (May 7, 2012), *available at* https://www.justice.gov/opa/pr/abbott-labs-pay-15-billion-resolve-criminal-civil-investigations-label-promotion-depakote [https://perma.cc/H8AV-T5JD].

84. Press Release, U.S. Dep't of Justice, Johnson & Johnson to Pay More Than $2.2 Billion to Resolve Criminal and Civil Investigations (Nov. 4, 2013), *available at* https://www.justice.gov/opa/pr/johnson-johnson-pay-more-22-billion-resolve-criminal-and-civil-investigations [https://perma.cc/F6DS-4KWN].

85. Press Release, U.S. Attorney's Office: S. Dist. of N.Y., U.S. Dep't of Justice, Acting Manhattan U.S. Attorney Announces Award of $296 Million Judgment Against Allied Home Mortgage Entities for Civil Mortgage Fraud (Sept. 19, 2017), *available at* https://www.justice.gov/usao-sdny/pr/acting-manhattan-us-attorney-announces-award-296-million-judgment-against-allied-home [https://perma.cc/YWG7-WDVB].

86. *Id.*

87. Press Release, U.S. Dep't of Justice, PHH Agrees to Pay Over $74 Million to Resolve Alleged False Claims Act Liability Arising from Mortgage Lending (Aug. 8, 2017), *available at* https://www.justice.gov/opa/pr/phh-agrees-pay-over-74-million-resolve-alleged-false-claims-act-liability-arising-mortgage [https://perma.cc/TD2Q-ZEM3].

alleged that PHH Mortgage Corp. originated and underwrote federally insured and guaranteed mortgage loans that were then purchased by the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation that did not meet the necessary requirements for FHA insurance.[88] Acting Assistant Attorney General Chad A. Readler stated, "The Department has and will continue to hold accountable lenders that knowingly cause the government to guarantee, insure, or purchase loans that are materially deficient and put both the homeowner and the taxpayers at risk."[89]

In February 2012, Flagstar Bank settled a lawsuit for $132.8 million based on claims of a FCA violation relating to "improperly approving residential home mortgage loans for government insurance."[90] Flagstar Bank admitted in the settlement that it submitted false certifications to the U.S. Department of Housing and Urban Development ("HUD"). It employed underwriting assistants who lacked the proper qualifications to perform key underwriting tasks, such as making final decisions on whether requisite conditions for FHA insurance were met.[91] It also allegedly "endorsed loans for FHA insurance that did not comply with HUD's underwriting requirements and thus were not eligible for government insurance."[92]

Also in February 2012, CitiMortgage Inc., a subsidiary of CitiBank, N.A., was penalized under the FCA and FIRREA in connection with its participation in the FHA direct endorsement lender program.[93] CitiMortgage failed to comply with basic requirements of the program, such as quality control and certifications.[94] CitiMortage eventually agreed to a $158.3 million settlement.[95] Finally, in 2016, PNC Bank settled claims relating to their alleged violation of the FCA for $9.5 million.[96] This came from allegedly

88. *Id.*

89. *Id.*

90. Press Release, U.S. Attorney's Office: S. Dist. of N.Y., U.S. Dep't of Justice, Manhattan U.S. Attorney Sues Flagstar Bank for Fraudulent Mortgage Lending Practices and Settles for $132.8 Million and Other Concessions (Feb. 24, 2012), *available at* https://www.justice.gov/archive/usao/nys/pressreleases/February12/flagstarbanksettlement.html [https://perma.cc/2H9G-Y5LV].

91. *Id.*

92. *Id.*

93. Press Release, U.S. Attorney's Office: S. Dist. of N.Y., U.S. Dep't of Justice, Manhattan U.S. Attorney Files and Simultaneously Settles Fraud Lawsuit Against CitiMortgage, Inc. for Reckless Mortgage Lending Practices (Feb. 15, 2012), *available at* https://www.justice.gov/archive/usao/nys/pressreleases/February12/citimortgageincsettlement.html [https://perma.cc/6L6N-5FMZ].

94. *Id.* ("Since 2004, [CitiMortgage] has endorsed nearly 30,000 mortgages for FHA insurance. Although [CitiMortgage] certified that each of these loans was eligible for FHA insurance, it repeatedly submitted certifications that were knowingly or recklessly false.").

95. *Id.*

96. Press Release, U.S. Attorney's Office: Dist. of Md., U.S. Dep't of Justice, PNC Bank to Pay $9.5 Million for Failing to Engage in Prudent Underwriting Practices for Loans Guaranteed by the U.S. Small Business Administration (Aug. 16, 2016), *available at* https://

fraudulent practices "in connection with the issuance of loans guaranteed by the U.S. Small Business Administration (SBA)."[97] The DOJ alleged that PNC did not adhere to certain important requirements such as "demanding adequate bank and IRS tax records from the borrowers, [and] ensuring that the borrowers had the ability to repay the loans."[98] These examples provide not only a view of the FCA claims on individual companies, but their impact on the industry and enforcement threats on similarly situated companies.

Healthcare and the financial services are not the only industries susceptible to FCA scrutiny. The energy industry is also targeted for attack under the FCA. The DOJ "Fact Sheet" reveals that from 2009 to 2012, the DOJ recovered more than $146 million from 13 oil and gas companies which knowingly underpaid royalties for gas extracted.[99] Those companies include Chevron (paid more than $45 million) and Mobil Oil Companies (paid more than $32 million).[100] To sum up, during recent years, the DOJ and its colleagues intensified their focus on FCA enforcement and on specific industries such as healthcare, financial services, and energy, showing a macro legal issue facing these industries.

C. *Bank Secrecy Act and Anti-Money Laundering*

In recent years U.S. regulators have heightened requirements and strengthened enforcement regarding the compliance of financial institutions with the Financial Recordkeeping and Reporting of Currency and Foreign Transaction Act of 1970[101] (commonly referred to as the Bank Secrecy Act ("BSA") and Anti-Money Laundering ("AML") laws). The Financial Crimes Enforcement Network ("FinCEN")—the U.S. Treasury's lead agency for combatting money laundering—leads this enforcement.[102] In 2016, FinCEN released new requirements for customer due diligence and identification of beneficial owners.[103] In recent years, both the SEC and the Financial Industry Regulatory Authority ("FINRA") also have announced an intention to focus on AML.[104] At the state level, an active role is being played by the New York

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www.justice.gov/usao-md/pr/pnc-bank-pay-95-million-failing-engage-prudent-underwriting-practices-loans-guaranteed-us [https://perma.cc/B2WC-KS4N].

97. *Id.*

98. *Id.*

99. U.S. DEP'T OF JUSTICE, FACT SHEET: SIGNIFICANT FALSE CLAIMS ACT SETTLEMENTS & JUDGEMENTS: FISCAL YEARS 2009–2016 (2016), *available at* https://www.justice.gov/opa/press-release/file/918366/download [https://perma.cc/7JUP-P2VU].

100. *Id.*

101. 31 U.S.C. §§ 5311–5332 (2012).

102. *FinCEN's Mandate from Congress*, FIN. CRIMES ENFORCEMENT NETWORK, https://www.fincen.gov/resources/fincens-mandate-congress [https://perma.cc/SY3W-EUBG].

103. Customer Due Diligence Requirements for Financial Institutions, 81 Fed. Reg. 29,398, 29,398–402 (May 11, 2016) (codified at 31 C.F.R. pts. 1010, 1020, 1023, 1024, 1026).

104. *See* FIN. INDUS. REGULATORY AUTH., 2017 ANNUAL REGULATORY AND EXAMINATION PRIORITIES LETTER 8 (2017), *available at* http://www.finra.org/sites/default/files/2017-

State's Department of Financial Services ("DFS").[105] Thus, creating compliance requirements and risks specifically for the financial industry.

The targets of enforcement actions are typically banks and depository institutions. Between January 2002 and December 2015, 76.3 percent of AML/BSA enforcement cases were directed at banks and depository institutions.[106] In the years since the financial crisis of 2008, the world's biggest banks have been fined $321 billion.[107] The largest monetary penalties for BSA/AML violations were imposed from 2010–2018. This includes a fine of $1.7 billion that was imposed on JPMorgan Chase Bank in 2014 for failure to report suspicious transactions arising out of Bernard Madoff's multi-billion dollar Ponzi scheme;[108] as well as penalties of more than $600 million imposed on the U.S. Bancorp, the fifth largest bank in the United States, for violations of the BSA, for maintaining a defective anti-money laundering program, and for failing to report suspicious banking activities of former racecar driver Scott Tucker.[109]

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regulatory-and-examination-priorities-letter.pdf [https://perma.cc/X7WT-D69F] ("In 2017, FINRA will continue to focus on firms' anti-money laundering programs, especially those areas where we have observed shortcomings."); OFFICE OF COMPLIANCE INSPECTIONS & EXAMINATIONS, SEC, EXAMINATION PRIORITIES FOR 2017, at 4 (2017), *available at* https://www.sec.gov/about/offices/ocie/national-examination-program-priorities-2017.pdf [https://perma.cc/6NE5-JWJ4] ("Money laundering and terrorist financing continue to be risk areas that are considered in our examination program.").

105. Most importantly, DFS adopted Part 504, a wide-reaching set of requirements for the AML. This became effective in January 2017 and imposes a significant burden on institutions. *See* Press Release, Richard Loconte, N.Y. State Dep't of Fin. Servs., DFS Issues Final Anti-Terrorism Transaction Monitoring and Filtering Program Regulation (June 30, 2016), *available at* https://www.dfs.ny.gov/about/press/pr1606301.htm [https://perma.cc/BHD2-Y548]; *see also* Brad S. Karp, *The Regulatory and Enforcement Outlook for Financial Institutions in 2017*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Mar. 8, 2017), https://corpgov.law.harvard.edu/2017/03/08/the-regulatory-and-enforcement-outlook-for-financial-institutions-in-2017 [https://perma.cc/5UZC-5EA5] (discussing recent developments and trends in AML in general and with regard to Part 504 in particular).

106. SHARON BROWN-HRUSKA, NERA ECON. CONSULTING, DEVELOPMENTS IN BANK SECRECY ACT AND ANTI-MONEY LAUNDERING ENFORCEMENT AND LITIGATION 4 (2016), *available at* http://www.nera.com/content/dam/nera/publications/2016/PUB_Developments_BSA_AML_Lit-06.16.pdf [https://perma.cc/W3QH-CEA6].

107. Gavin Finch, *World's Biggest Banks Fined $321 Billion Since Financial Crisis*, BLOOMBERG (Mar. 1, 2017, 11:01 PM), https://www.bloomberg.com/news/articles/2017-03-02/world-s-biggest-banks-fined-321-billion-since-financial-crisis [https://perma.cc/9XXH-DJ5G].

108. Press Release, U.S. Attorney's Office: S. Dist. of N.Y., U.S. Dep't of Justice, Manhattan U.S. Attorney and FBI Assistant Director-in-Charge Announce Filing of Criminal Charges Against and Deferred Prosecution Agreement with JPMorgan Chase Bank, N.A., in Connection with Bernard L. Madoff's Multi-Billion Dollar Ponzi Scheme (Jan. 7, 2014), *available at* https://www.justice.gov/usao-sdny/pr/manhattan-us-attorney-and-fbi-assistant-director-charge-announce-filing-criminal [https://perma.cc/ZGV9-64E7].

109. Press Release, U.S. Attorney's Office: S. Dist. of N.Y., U.S. Dep't of Justice, Manhattan U.S. Attorney Announces Criminal Charges Against U.S. Bancorp for Violations of the Bank Secrecy Act (Feb. 15, 2018), *available at* https://www.justice.gov/usao-sdny/pr/manhattan-us-

It certainly looks as if AML/BSA enforcement is going to remain at the forefront of the U.S. legislative and regulatory priorities in the coming years. Recently, Congress has shown interest in updating AML laws, proposing multiple new bills,[110] and engaging in a number of discussions.[111] Similar to the examples of the Foreign Corrupt Practices Act and the False Claims Act discussed above, the Bank Secrecy Act and Anti-Money Laundering are classic examples of a law and regulation that are focused on specific industries.

D. Environmental Law

Companies also face legal exposure regarding enforcement of environmental laws and regulations, displaying a macro legal risk to the energy, gas, and oil industry.[112] In the past few years alone, the DOJ and the U.S. Environmental Protection Agency ("EPA") have issued a number of consent decrees and reached various settlements that have penalized oil, gas and energy companies who have violated the Clean Air Act ("CAA"). In December 2017, the EPA, DOJ and Sid Richardson Carbon and Energy Company entered into a settlement in which Sid Richardson was forced to install state-of-the-art pollution control technologies to reduce emissions of harmful air pollutants.[113] The settlement will prove to be a major cost to Sid Richardson as the controls they are mandated to put in place are "estimated to cost over $100 million."[114] On top of this, Sid Richardson will have to "pay civil penalties of $999,000."[115]

Only a few months earlier, Exxon Mobil also entered into a settlement with the DOJ and the EPA in response to alleged CAA violations.[116] The DOJ

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attorney-announces-criminal-charges-against-us-bancorp-violations-bank [https://perma.cc/PF4T-DXXG].

110. *See, e.g.*, Anti-Money Laundering and Counter-Terrorism Financing Modernization Act, H.R. 4373, 115th Cong. (2017); Combating Money Laundering, Terrorist Financing, and Counterfeiting Act of 2017, S. 1241, 115th Cong.

111. *See, e.g.*, *Combating Money Laundering and Other Forms of Illicit Finance: Opportunities to Reform and Strengthen BSA Enforcement: Hearing Before the S. Comm. on Banking, Hous., & Urban Affairs*, 115th Cong. (2018), *available at* https://www.banking.senate.gov/hearings/combating-money-laundering-and-other-forms-of-illicit-finance-opportunities-to-reform-and-strengthen-bsa-enforcement [https://perma.cc/7X7U-FH9E].

112. *See, e.g.*, Paul J. Larkin, Jr., *Funding Favored Sons and Daughters: Nonprosecution Agreements and "Extraordinary Restitution" in Environmental Criminal Cases*, 47 LOY. L.A. L. REV. 1, 5–16 (2013).

113. Press Release, U.S. EPA, EPA, DOJ Announce Settlement Agreement with Carbon Black Producer, Sid Richardson Carbon and Energy Company (Dec. 22, 2017), *available at* https://www.epa.gov/newsreleases/epa-doj-announce-settlement-agreement-carbon-black-producer-sid-richardson-carbon-and [https://perma.cc/6RXD-DYZT].

114. *Id.*

115. *Id.*

116. Press Release, U.S. Dep't of Justice, Under Agreement with the Justice Department and Environmental Protection Agency, Exxonmobil to Reduce Harmful Air Pollution at Eight U.S. Chemical Plants (Oct. 31, 2017), *available at* https://www.justice.gov/opa/pr/under-agreement-justice-department-and-environmental-protection-agency-exxonmobil-reduce [https://perma.cc/88HE-VB89].

and EPA had argued "that ExxonMobil violated the Clean Air Act by failing to properly operate and monitor industrial flares at their petrochemical facilities, which resulted in excess emissions of harmful air pollution."[117] As part of the settlement, Exxon Mobil will need "to install and operate air pollution control and monitoring technology to reduce harmful air pollution" at five facilities in Texas and three facilities in Louisiana.[118] This is expected to cost about $300 million.[119] Exxon Mobil will also need to pay a civil penalty of $2.5 million.[120] On the same day that the Exxon Mobil Settlement was reached, the DOJ, EPA and PDC Energy, Inc. agreed to a settlement based on alleged CAA violations.[121] These violations related to "emissions from its oil and gas exploration and production activities in the Denver area."[122] As part of the settlement, PDC Energy will have to spend approximately $18 million to improve and update its systems, operations, monitoring, and inspection capabilities.[123] It will also have to pay a $2.5 million civil penalty.[124]

Finally, in 2015, the EPA and DOJ announced a consent decree with Interstate Power and Light, a subsidiary of Alliant Energy, over violations of the CAA.[125] This was based on alleged harmful air pollution from coal-fired power plants that Interstate Power and 2Light owned in Iowa.[126] As part of the settlement, Interstate Power and Light will have to invest $6 million in environmental mitigation projects.[127] On top of this, it will have to pay a $1.1 million civil penalty.[128] Perhaps most importantly, Interstate Power and Light will have to install and operate new, state-of-the-art pollution controls, which "are expected to cost approximately $620 million."[129] This settlement not only exemplified the cost to Interstate Power and Light, but the costs to the industry as a whole.

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117. *Id.*

118. *Id.*

119. *Id.*

120. *Id.*

121. Press Release, U.S. EPA, DOJ, EPA and State of Colorado Reach Agreement with PDC Energy, Inc. to Resolve Litigation and Reduce Air Pollution (Oct. 31, 2017), *available at* https://www.epa.gov/newsreleases/doj-epa-and-state-colorado-reach-agreement-pdc-energy-inc-resolve-litigation-and-reduce [https://perma.cc/6SAG-XQ6Z].

122. *Id.*

123. *Id.*

124. *Id.*

125. Press Release, U.S. Dep't of Justice, Settlement with Interstate Power and Light to Reduce Emissions from Iowa Power Plants, Fund Projects to Benefit Environment and Communities (July 15, 2015), *available at* https://www.justice.gov/opa/pr/settlement-interstate-power-and-light-reduce-emissions-iowa-power-plants-fund-projects [https://perma.cc/LF63-6JLY].

126. *Id.*

127. *Id.*

128. *Id.*

129. *Id.*

E. *Antitrust*

Much like FCPA, FCA and CAA violations, the antitrust treatment of certain industries in the United States is an excellent example of a macro legal risk that institutional investors with common ownership holdings can better address due to the advantage obtained through common ownership. First, over the past several years, top U.S. banks have faced hefty antitrust fines. In what became known as the "Forex Scandal," giant banks colluded for years in order to manipulate the foreign-exchange market, to the detriment of other parties who were not aware of the manipulative scheme.[130] Among the penalized banks were the American giants Citigroup, which agreed to pay a fine of $925 million,[131] and JPMorgan, which agreed to pay a fine of $550 million.[132] "Bank of America Corp. has agreed to pay $180 million to settle a lawsuit [filed] by private investors who accused the bank . . . of manipulating [the Forex] rates."[133] Similar to the banking industry, over the past few years, the DOJ has made it an official policy to closely monitor antitrust issues in the agricultural industry.[134] These issues relate to antitrust concerns that have

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130. Philip Augar, *How the Forex Scandal Happened*, BBC NEWS (May 20, 2015), https://www.bbc.com/news/business-30003693 [https://perma.cc/Y6VZ-9L8P]; Press Release, U.S. Dep't of Justice, Five Major Banks Agree to Parent-Level Guilty Pleas (May 20, 2015), *available at* https://www.justice.gov/opa/pr/five-major-banks-agree-parent-level-guilty-pleas [https://perma.cc/3YVB-CXRX].

131. Plea Agreement at 9, United States v. Citicorp, No. 3:15-cr-00078-SRU (D. Conn. May 20, 2015).

132. Plea Agreement at 9, United States v. JPMorgan Chase & Co., No. 3:15-cr-00079-SRU (D. Conn. May 20, 2015).

133. Christina Rexrode, *Bank of America to Pay $180 Million to Settle Investors' Forex Lawsuit*, WALL ST. J. (Apr. 29, 2015, 6:06 PM), https://www.wsj.com/articles/bank-of-america-to-pay-180-million-to-settle-private-forex-lawsuit-1430340190 [https://perma.cc/V4C8-XL49].

134. *See, e.g.*, U.S. DEP'T OF JUSTICE, COMPETITION AND AGRICULTURE: VOICES FROM THE WORKSHOPS ON AGRICULTURE AND ANTITRUST ENFORCEMENT IN OUR 21ST CENTURY ECONOMY AND THOUGHTS ON THE WAY FORWARD 2 (2012), *available at* https://www.justice.gov/sites/default/files/atr/legacy/2012/05/16/283291.pdf [https://perma.cc/T4KU-SSS4] [hereinafter U.S. DEP'T OF JUSTICE, COMPETITION AND AGRICULTURE] ("A number of participants (including Division staff and leadership) stressed the importance of vigorous antitrust enforcement and detailed the ways that anticompetitive mergers and conduct can harm producers, consumers, and others."); *id.* at 23 ("Vigorous antitrust enforcement is imperative, and the Division has redoubled its already active enforcement activities."); *see also* Douglas Ross, Special Counsel for Agric. Antitrust Div., U.S. Dep't of Justice, Address to the R-CALF USA Annual Convention (Jan. 19, 2007), *available at* https://www.justice.gov/atr/speech/antitrust-enforcement-and-agriculture-1 [https://perma.cc /DUN3-DWTE] ("The Antitrust Division takes seriously its responsibility to protect the marketplace—including the agricultural marketplace—against anticompetitive conduct and against mergers that substantially lessen competition. As I hope I have made clear, the Division has a record of acting in this important sector when the antitrust laws are violated."); Christine A. Varney, Assistant Attorney Gen., Antitrust Div., U.S. Dep't of Justice, A Shared Vision for American Agricultural Markets, Remarks as Prepared for the Opening of the Department of Justice and Department of Agriculture Joint Workshops 3 (Mar. 12, 2010), *available at* https://www.justice.gov/atr/file/518226/download [https://perma.cc/YSV6-TZ4G] ("Indeed, as some of our public enforcement actions and investigations indicate, antitrust may have a major role to play in preserving the kind of open market that allows farmers to negotiate for fair input

risen due to mergers, acquisitions, and other activities that have the potential to involve price fixing. The antitrust division of the DOJ shares responsibility with the Federal Trade Commission ("FTC") for investigating and prosecuting these claims.[135] The DOJ will sue if a merger is likely to lead to either anticompetitive prices for products purchased by farmers, or to anticompetitive prices for products sold by farmers.[136]

Over the past decade, the DOJ and FTC have challenged a number of mergers based on anticompetitive effects. These include a 2010 challenge to Dean Foods Company's acquisition of Foremost Farms USA's Consumer Products Division,[137] a challenge to the acquisition of National Beef by JBS,[138] a 2011 challenge to George's Inc.'s acquisition of Tyson Foods' chicken-processing complex,[139] and a 2016 challenge in which the DOJ sued Deere &

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prices and competitive returns on their investment."); *id.* at 4 ("To put it simply: where the Division's powers can be used to ensure fair and efficient prices on the farm, they will be."). Barack Obama also made antitrust enforcement of the agricultural sector a priority during his time as President. *See* Scott P. Perlman, *Antitrust Enforcement in US Agricultural Markets: The Obama Administration Plants Seeds for Increased Enforcement*, MAYER BROWN (Dec. 9, 2009), https://m.mayerbrown.com/publications/antitrust-enforcement-in-us-agriculture-markets-the-obama-administration-plants-seeds-for-increased-enforcement-12-10-2009 [https://perma.cc/L3VP-7C7A].

135. *Antitrust Enforcement in Agriculture: Hearing Before the S. Comm. on Agric., Nutrition, & Forestry*, 106th Cong. 82 (2000) (statement of John M. Nannes, Deputy Assistant Att'y Gen., Antitrust Division, U.S. Department of Justice), *available at* https://www.govinfo.gov/content/pkg/CHRG-106shrg68888/pdf/CHRG-106shrg68888.pdf [https://perma.cc/3B59-4P2L].

136. *Id.* at 90–91.

137. U.S. DEP'T OF JUSTICE, COMPETITION AND AGRICULTURE, *supra* note 134, at 17. In this challenge the DOJ and FTC argued that the acquisition would eliminate important competition in the sale of milk in the Midwest. *Id.*

138. U.S. DEP'T OF JUSTICE, COMPETITION AND AGRICULTURE, *supra* note 134, at 17; Press Release, U.S. Dep't of Justice, Justice Department Files Lawsuit to Stop JBS S.A. from Acquiring National Beef Packing Co. (Oct. 20, 2008), *available at* https://www.justice.gov/archive/opa/pr/2008/October/08-at-936.html [https://perma.cc/5NXF-A68U]. The DOJ alleged that the acquisition of a major beef processor by a major beef packer would "plac[e] more than 80 percent of domestic fed cattle packing capacity in the hands of three firms." *Id.* This resulted in the abandonment of the transaction. Press Release, U.S. Dep't of Justice, Department of Justice Statement on the Abandonment of the JBS/National Beef Transaction (Feb. 20, 2009), *available at* https://www.justice.gov/opa/pr/department-justice-statement-abandonment-jbsnational-beef-transaction [https://perma.cc/F2QD-9VAJ].

139. U.S. DEP'T OF JUSTICE, COMPETITION AND AGRICULTURE, *supra* note 134, at 17; Press Release, U.S. Dep't of Justice, Justice Department Files Antitrust Lawsuit Challenging George's Inc.'s Acquisition of Tyson Foods Inc.'s Harrisonburg, Va., Poultry Processing Complex (May 10, 2011), *available at* https://www.justice.gov/opa/pr/justice-department-files-antitrust-lawsuit-challenging-george-s-inc-s-acquisition-tyson-foods [https://perma.cc/6BPW-RYN8]. The DOJ argued that the acquisition would eliminate substantial competition for chicken processing services and harm chicken growers in Virginia. *Id.* In 2011, the DOJ and George's Inc. reached a settlement which requires George's to make capital improvements to the chicken processing plant, increasing the number of chickens that can be processed at the facility. Press Release, U.S. Dep't of Justice, Justice Department Reaches Settlement with George's Inc. (June 23, 2011),

Company and Precision Planting LLC, a subsidiary of Monsanto Company, over a proposed acquisition which would have had anticompetitive effects on "the market for high-speed precision planting systems."[140]

In response to concerns of stakeholders regarding DOJ action and enforcement, the DOJ antitrust division has held workshops in order to inform relevant stakeholders of the risks of certain behaviors and practices.[141] Based on these workshops, DOJ determined that it has an important role to play in the agricultural sector and "that a healthy agricultural sector requires competition and, consequently, vigorous antitrust enforcement."[142]

Another industry that has been subject to a recent enforcement push by the DOJ in antitrust cases is the generic drug industry. In December 2016, two executives of Heritage Pharmaceuticals were charged by the DOJ with price fixing for antibiotics and diabetes treatments.[143] Since 2014, pharmaceutical companies have been receiving subpoenas relating to price fixing.[144] Among the American pharmaceutical companies that have been subpoenaed by the antitrust division of the DOJ are Perrigo Co., Lannett Co. Inc., Impax Laboratories Inc., Par Pharmaceutical Cos. Inc., and Taro Pharmaceuticals USA Inc.[145]

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available at https://www.justice.gov/opa/pr/justice-department-reaches-settlement-george-s-inc [https://perma.cc/FR2W-H48G].

140. Complaint at 2, 4, United States v. Deere & Co., No. 16-08515 (N.D. Ill. Aug. 31, 2016). The DOJ alleged that if the merger were allowed to take place, it would effectively end all competition in the industry and "Deere would control nearly every method through which American farmers can acquire effective high-speed precision planting systems." *Id.* at 4. In May 2017, Deere abandoned the proposed acquisition. Press Release, U.S. Dep't of Justice, Deere Abandons Proposed Acquisition of Precision Planting from Monsanto (May 1, 2017), *available at* https://www.justice.gov/opa/pr/deere-abandons-proposed-acquisition-precision-planting-monsanto [https://perma.cc/EXL9-3Q7N].

141. *Public Workshops: Agriculture and Antitrust Enforcement Issues in Our 21st Century Economy*, U.S. DEP'T JUST., https://www.justice.gov/atr/events/public-workshops-agriculture-and-antitrust-enforcement-issues-our-21st-century-economy-10 [https://perma.cc/97MP-JKSN] (last updated Aug. 29, 2019). The workshops brought together "[a] wide spectrum of interested parties, including farmers, ranchers, processors, retailers, workers, academics, law enforcers, regulators, and other federal, state, and local government officials." U.S. DEP'T OF JUSTICE, COMPETITION AND AGRICULTURE, *supra* note 134, at 2.

142. U.S. DEP'T OF JUSTICE, COMPETITION AND AGRICULTURE, *supra* note 134, at 2.

143. Press Release, U.S. Dep't of Justice, Former Top Generic Pharmaceutical Executives Charged with Price-Fixing, Bid-Rigging and Customer Allocation Conspiracies (Dec. 14, 2016), *available at* https://www.justice.gov/opa/pr/former-top-generic-pharmaceutical-executives-charged-price-fixing-bid-rigging-and-customer [https://perma.cc/7E8R-3QDU].

144. Eric Kroh, *DOJ Raids Perrigo in Generic Drug Price-Fixing Probe*, LAW360 (May 3, 2017, 1:20 PM), https://www.law360.com/articles/919989/doj-raids-perrigo-in-generic-drug-price-fixing-probe [https://perma.cc/ZF4J-K345].

145. *Id.*

F. Concluding Thoughts

As discussed in this Part, over the past few years, the DOJ and other enforcement authorities have focused on enforcement of macro legal issues, such as FCPA, antitrust, money laundering, environmental violations, and fraud.[146] It increasingly targeted groups of companies with common features or companies within the same industry, rather than on an individualized basis. The next Part of this Article further explains how monitoring macro legal risks can be done based on visible and verifiable elements (hard information). Such relatively high observability and verifiability is likely to enhance institutions' incentives and ability to oversee companies in which they invest, and to mitigate macro legal risks—as will be elaborated on in Part V of this Article. Overall, Parts III–IV serve as a basis for the argument of this Article, that a high level of common ownership enhances the incentives and ability of institutional investors to monitor macro legal risks and enhance corporate compliance with laws and regulations.

IV. The Nature of Macro-Legal Risks: Observability and Verifiability

Generally speaking, the incentives and ability of shareholders —particularly institutional investors—to monitor companies in which they invest, depends, first and foremost, on their ability to observe, understand and verify information about the actions of these companies.[147] While information

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146. It is worth noting that beyond macro legal risks of the nature discussed above, today large institutional investors face other challenges common to certain industries. Very prominent is the DOJ's obligation to ensure adequate cybersecurity. This is an obligation that has a dramatic influence on the technology industry. During the past few years, big tech firms such as Microsoft Corp., Apple Inc., Facebook Inc., Amazon.com Inc., and Google have been exposed to intensive attempts by the DOJ and other investigative authorities to access data stored by these firms. *See, e.g.*, Matt Apuzzo et al., *Apple and Other Tech Companies Tangle with U.S. Over Data Access*, N.Y. TIMES (Sept. 7, 2015), https://www.nytimes.com/2015/09/08/us/politics/apple-and-other-tech-companies-tangle-with-us-over-access-to-data.html [https://perma.cc/EVR4-6BCN]. The top five tech rivals "join forces" to push back against such attempts. *See* Dina Bass & David Ingold, *The Top Five Tech Rivals Join Forces to Shape Policy–and Fight the Government*, BLOOMBERG (June 27, 2017, 3:00 AM), https://www.bloomberg.com/news/features/2017-06-27/the-top-five-tech-rivals-join-forces-to-shape-policy-and-fight-the-government [https://perma.cc/D7FP-SRR7]. Technology firms enter a new era in which the DOJ and its colleagues "intend[] to take a more aggressive posture in seeking access to encrypted information from technology companies." *See* Del Quentin Wilber, *Justice Department to Be More Aggressive in Seeking Encrypted Data*, WALL ST. J. (Oct. 10, 2017, 3:44 PM), https://www.wsj.com/articles/justice-department-to-be-more-aggressive-in-seeking-encrypted-data-1507651438 [https://perma.cc/9E86-QMAZ]. Indeed, giant technology companies have not been required to pay civil and criminal fines, but they have invested majorly to protect consumer information. *See, e.g.*, Deborah D'Souza, *Tech Lobby: Internet Giants Spend Record Amounts, Electronics Firms Trim Budgets*, INVESTOPEDIA, https://www.investopedia.com/tech/what-are-tech-giants-lobbying-trump-era [https://perma. cc/6422-J4CX] (last updated June 25, 2019). In that sense, technology firms enter a new era of macro legal developments and exposure.

147. *See generally* Bengt Holmström, *Moral Hazard and Observability*, 10 BELL J. ECON. 74, 76 (1979) (explaining that the ability of the principal to control the agent depends on its ability to

can be classified in many ways, for the purpose of this Article, information about company behavior will be classified on a scale from "soft" (less observable) information to "hard" (more observable) information. Institutional investors' incentives and ability to voice their viewpoints are likely to be lower when dealing with soft information. It should be noted that incentives and abilities are interrelated in our context, i.e., when information is softer, it may be more difficult for institutions to analyze the issue and to formulate a position. In such circumstances, analysis and decision-making are likely to be costly, and consequently lower the incentives of institutional investors to act.

As Simone M. Sepe, who uses the term "soft" information in his recent article, explains, managers of companies invest in long-term projects, including "innovation and . . . intangible 'knowledge' assets, such as ideas, patents, . . . software, [and] copyrights."[148] Information on these projects' value, due to their very nature, "tends to be 'soft,'" and therefore difficult to observe and verify by outsiders in general.[149] This lowers the ability and incentives of institutions to voice their opinions and affect company decisions regarding such issues.[150]

Next on the scale is "semi-hard" information, composed of more visible elements that may guide investors on how to vote at shareholder meetings or how to communicate in other ways with management.[151] While semi-hard information is more verifiable and observable than soft information, semi-hard information still does not constitute classic "hard" information, and investors are required to expend effort in gathering and analyzing information on a case-by-case basis regarding a wide variety of issues. These issues are "transaction-driven" issues determined based on transaction-specific and firm-specific features.[152] Voting on such issues may include voting

observe the agent's action); Joseph E. Stiglitz, *Principal and Agent (ii)*, *in* THE NEW PALGRAVE DICTIONARY OF ECONOMICS 638 (Steven N. Durlauf & Laurence E. Blume eds., 2008) (explaining how a principal-agent problem arises when the principal has limited information concerning action that the agent has undertaken or should undertake).

148. Simone M. Sepe, *Board and Shareholder Power, Revisited*, 101 MINN. L. REV. 1377, 1381–82 (2017). Sepe elaborates on a theory that tries to balance the allocation of power between shareholders and board authority. *Id.* at 1384–85.

149. *Id.* at 1382; *see also* Zohar Goshen & Assaf Hamdani, *Corporate Control and Idiosyncratic Vision*, 125 YALE L.J. 560, 567 (2016) (discussing the subjective value that an entrepreneur may attach to her idiosyncratic vision and explaining how the entrepreneur's idiosyncratic vision "reflects the parts of the entrepreneur's business idea that outsiders may be unable to observe or verify").

150. Sepe, *supra* note 148, at 1381–82.

151. The "semi-hard" terminology is first used here to fill out the scale between soft information and hard information.

152. Stephen J. Choi et al., *Director Elections and the Role of Proxy Advisors*, 82 S. CAL. L. REV. 649, 660 n.60 (2009) (using the "transaction-driven" term in the context of voting on director election); *see also* Stephen M. Bainbridge, *The Case for Limited Shareholder Voting Rights*, 53 UCLA L. REV. 601, 629 (2006) ("[Institutional investors] typically disclaimed the ability or desire to decide company-specific policy questions.").

on splitting the Chairman and CEO roles, quality and diversity of the Boards of Directors, director elections, compensation structures, and mergers and acquisitions. Voting on these issues, although involving pre-determined considerations, requires investors to apply considerable discretion and to conduct firm-specific analysis, and therefore must be determined for each specific case.

For example, the Institutional Shareholder Services Inc. ("ISS"), the leading global proxy advisory firm advising institutional investors on how to vote their shares, bases its voting advice on issues of executive compensation on relative evaluations of financial metrics such as total shareholder return ("TSR"), return on equity, return on assets, return on invested capital, revenue growth, earnings before interest, taxes, depreciation, and amortization ("EBITDA") growth, and cash flow (from operations) growth.[153] In the context of director elections, voting can be based, for example, on directors' qualifications, attendance,[154] and the number of other company boards on which the director sits (multiple directorships).[155] It is clear that such factors require investors to conduct case-by-case analysis and voting.[156]

Relatedly, many of these "semi-hard" issues are highly controversial and contestable, and therefore investors may face difficulties in persuading management of their positions. Contestable issues include board composition, anti-takeover provisions[157] (especially board declassifications[158]

153. James Chen, *EBITDA Margin*, INVESTOPEDIA, https://www.investopedia.com/terms/e/ebitda-margin.asp [https://perma.cc/9DMP-7YLH] (last updated Sept. 10, 2019); Press Release, Institutional S'holder Servs. Inc., ISS Announces Pay-for-Performance Methodology Updates for 2017: Six New Financial Metrics to Supplement TSR (Nov. 8, 2016), *available at* https://www.issgovernance.com/iss-announces-pay-performance-methodology-updates-2017 [https://perma.cc/U682-REW9]; *see also* Yonca Ertimur et al., *Shareholder Votes and Proxy Advisors: Evidence from Say on Pay*, 51 J. ACCT. RES. 951, 953 (2013) (explaining that voting on executive pay is highly firm-specific, complex and inherently subjective nature).

154. *See, e.g.*, Ying-fen Lin et al., *Supervisory Quality of Board and Firm Performance: A Perspective of Board Meeting Attendance*, 25 TOTAL QUALITY MGMT. & BUS. EXCELLENCE 264, 266–67 (2014); Nikos Vafeas, *Board Meeting Frequency and Firm Performance*, 53 J. FIN. ECON. 113, 114 (1999).

155. *See, e.g.*, Choi et al., *supra* note 152, at 661.

156. As proxy advisors emphasize, "[e]ven where the criteria appear to be objective, . . . they are examined and applied on a case-by-case basis." *See id.* at 659 n.57.

157. *See* Lucian A. Bebchuk & Alma Cohen, *The Costs of Entrenched Boards*, 78 J. FIN. ECON. 409, 410 (2005) ("Whether it is desirable to protect the boards of publicly traded companies from removal by shareholders has long been the subject of much debate.").

158. Steven Davidoff Solomon, *The Case Against Staggered Boards*, N.Y. TIMES: DEALBOOK (Mar. 20, 2012, 12:43 PM), https://dealbook.nytimes.com/2012/03/20/the-case-against-staggered-boards [https://perma.cc/3J7Y-2BPX] (noting that the debate over the value of staggered boards "is likely to continue for a long time").

and poison pills[159]), splitting the CEO and Chairman roles,[160] setting executive compensation,[161] and more.

On the other side of the scale is information relating to the macro legal risks that are at the heart of this Article. This information can be classified as "hard" information. When dealing with macro legal risks, investors should be able to answer two related questions: (1) whether companies in which they invest are subject to macro legal risks, and if so, (2) whether they have taken precautionary steps to deal with such risks. These two questions can typically be answered with a simple, unqualified "yes" or "no." Regarding the first question, as explained in Part III above, enforcement efforts of the DOJ and the SEC target companies with common features.[162] Within the FCPA context, for example, the DOJ and SEC target companies that belong to the oil or pharma industries, do business in regions such as Latin America and Central and Eastern Europe, and rely heavily on third-parties and other agents for the marketing and distribution of their products. Such companies are heavily susceptible to FCPA enforcement,[163] and institutional investors can recognize whether companies have such features in a relatively easy manner, thereby answering the first question.

Regarding the second question, institutional investors should examine whether these companies have an appropriate set of mechanisms capable of dealing with legal risks. In the FCPA context, investors should make sure that companies have adopted policies and procedures designed to prevent prohibited conduct. For pharmaceutical companies, this could "includ[e] the establishment of a system to monitor transactions with members of the health care community[,] . . . an improved anti-corruption training program[,] . . . a standalone third-party due diligence program," independent control functions, creating "an office charged with addressing reports of

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159. Jordan M. Barry & John William Hatfield, *Pills and Partisans: Understanding Takeover Defenses*, 160 U. PA. L. REV. 633, 635 (2012) ("There is no consensus on the systemic effects of takeover defenses in general, or of the most important defense mechanism—the shareholder rights plan or 'poison pill'—in particular.").

160. Jena McGregor, *A Reason to Split the Role of CEO and Chairman*, WASH. POST (July 2, 2012), https://www.washingtonpost.com/blogs/post-leadership/post/a-reason-to-split-the-role-of-ceo-and-chairman/2012/07/02/gJQAewK9HW_blog.html [https://perma.cc/PE2N-XZFQ] ("A long-brewing debate in corporate America has centered on whether or not the job of CEO and chairman should be split."); David F. Larcker & Brian Tayan, Chairman and CEO: The Controversy Over Board Leadership Structure 1 (June 24, 2016) (unpublished manuscript), *available at* https://www.gsb.stanford.edu/sites/gsb/files/publication-pdf/cgri-closer-look-58-independent-chair.pdf [https://perma.cc/433P-99B2] ("One of the most controversial issues in corporate governance is whether the CEO of a corporation should simultaneously serve as chairman of the board.").

161. *See generally* Carola Frydman & Dirk Jenter, *CEO Compensation*, 2 ANN. REV. FIN. ECON. 75 (2010) (describing methods of setting executive compensation).

162. *See supra* Part III.

163. *See supra* Section III.A.

misconduct[,] and . . . a dedicated Global Compliance Audit group,"[164] as well as improved mechanisms to ensure that no illegal influence will be made through means that seem to be legitimate such as marketing events, educational seminars and medical studies.[165] Importantly, investors should also place key compliance personnel in markets recognized as high-risk.[166]

Taken together, macro legal risks require institutional investors to determine the exposure and preparedness of companies to legal risks, based on elements that are highly visible and verifiable. Because these elements are both highly visible and verifiable, management is likely to be more easily persuaded to implement the necessary changes. This therefore increases the incentives and lowers the costs of responding to such legal risks.

V. THE VIRTUE OF COMMON OWNERSHIP IN AN ERA OF CORPORATE COMPLIANCE

These benefits discussed in Part IV will allow institutional investors to supervise companies in which they invest more effectively, which can help them minimize corporate wrongdoing. The three inter-related merits of common ownership, which will be discussed in turn in this Part, are (1) enhanced incentives for monitoring macro legal risks; (2) privileged access to rulemaking and lawmaking that allows institutional investors to recognize legal developments; and (3) experimental learning of macro legal risks.

A. INCENTIVES

Incentives of institutional investors to monitor their portfolio companies depend on the relative costs and benefits of monitoring. To be precise, in the context of this Article, institutional investors can be categorized into two types: passive index funds, led by BlackRock, Vanguard and State Street Global Advisors; and actively managed funds led by Fidelity and the Capital Group. Passive index funds are designed to mimic stock indices (rather than

164. For an example where these measures were suggested, see, for example, Deferred Prosecution Agreement at 4, United States v. Teva Pharm. Indus. Ltd., No. 1:16-cr-20968-FAM (S.D. Fla. 2016) (listing remediation measures pharmaceutical giant Teva engaged in as part of a deferred prosecution agreement for FCPA violations).

165. *See, e.g.*, Novartis AG, *supra* note 67, at *5 ("As a result of its internal review over relationships with local Chinese third-party travel and event planning vendors, Novartis identified weaknesses in its internal controls over third party relationships at Novartis China. Novartis promptly took remedial steps to improve its internal controls at Novartis China including overhauling its anti-corruption policies and procedures, terminating and/or imposing other disciplinary sanctions against culpable employees, suspending vendor relationships and payments, doubling its training initiatives, re-organized its compliance function to include enhanced oversight by regional and headquarter compliance personnel, and eliminated the use of vendors to support external meetings.").

166. *See, e.g.*, AstraZeneca PLC, *supra* note 68, at *3 ("[AstraZeneca] has developed a centralized compliance program, revamped its internal controls and procedures, and placed key compliance personnel in high-risk local markets.").

outperform them), often at lower costs. They compete amongst themselves for the lowest tracking error performance, and the lowest cost. Therefore, according to the prevailing wisdom, they have weak incentives to invest resources in corporate governance. Regarding costs, when monitoring is time consuming and costly, incentives are likely to be lower. Regarding benefits, when monitoring is likely to minimize exposure of companies in which institutional investors invest to macro legal risks, this benefit may encourage institutional investors to better monitor these companies. As this Part demonstrates, when dealing with macro legal risks, costs are likely to be low while benefits are likely to be high. This is because common ownership creates aggregate exposure to legal risk and allows institutional investors to enjoy economies of scale. Therefore, costs of monitoring are low, and the process is not time consuming, and the benefits of monitoring are high, as companies face similar legal risk. Accordingly, institutional investors should have strong incentives to monitor their portfolio companies when dealing with macro legal risks, as the benefits greatly outweigh the costs.[167]

1. Low Costs of Identifying and Responding to the Macro Legal Trends

Traditionally, institutional investors have been criticized for being passive investors that fail to fulfill their intended tasks of supervising and monitoring their portfolio companies, and "lazy investors,"[168] "reluctant activists,"[169] and

167. *See* Lucian A. Bebchuk et al., *The Agency Problems of Institutional Investors*, J. ECON. PERSP. 89, 95–98 (2017). Still, however, passive index funds compete not just amongst themselves, but also with actively managed funds. *See* Jill E. Fisch et al., *The New Titans of Wall Street: A Theoretical Framework for Passive Investors* 4–6 (European Corp. Governance Inst., Working Paper No. 414, 2019), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3192069 [https://perma.cc/48AD-HDVT]. Further, there is evidence showing that passive funds do play an important role in corporate governance that can lead to positive governance outcomes. *See generally* Ian R. Appel et al., *Passive Investors, Not Passive Owners*, 121 J. FIN. ECON. 111 (2016) (finding that engagement by passive funds leads to an increase in board independence, removal of takeover defenses, such as poison pills, and an increase in the likelihood of reducing restrictions on shareholders' ability to call special meetings). More relevant to the purposes of this Article, as I will explain, the costs of dealing with macro legal risks, unlike classic corporate governance issues, are lower. I will elaborate further on this point in Part VI. Justification for engagement related to macro legal risks is even stronger for actively managed funds, such as Fidelity, that also have (or could choose to have) common holdings. Actively managed funds compete with low cost index funds. They charge higher fees than index funds, so they have a strong incentive to generate sufficient returns to justify their high fees. *See* Burton G. Malkiel, *Asset Management Fees and the Growth of Finance*, 27 J. ECON. PERSP. 97, 102–03 (2013). The higher a fund's fees, the higher the return a manager must earn to overcome those higher costs. This is likely to justify dealing with macro legal risks which involve low costs and are likely to yield significant value for the fund's portfolio.

168. *Capitalism's Unlikely Heroes*, ECONOMIST (Feb. 5, 2015), https://www.economist.com/news/leaders/21642169-why-activist-investors-are-good-public-company-capitalisms-unlikely-heroes [https://perma.cc/X7RK-4D9Q].

169. Robert C. Pozen, *Institutional Investors: The Reluctant Activists*, HARV. BUS. REV. (Jan.–Feb. 1994), https://hbr.org/1994/01/institutional-investors-the-reluctant-activists [https://perma.cc/HLW4-ZG74].

"sleeping giant[s] of corporate governance."[170] Their business model has been argued to not provide institutional investors with the necessary incentives to play a more active role in corporate governance and become better stewards of the companies in which they invest.[171] As Edward B. Rock recently put it, even regulatory intervention is "unlikely to transform institutional investors into 'stewards' of portfolio companies."[172] Thus, one might be skeptical regarding the incentives of institutional investors to deal with macro legal risks.

However, the traditional criticism regarding investors' (lack of) *activism*, specifically institutional investors, has been based on their role in *proxy voting*, and not on their monitoring role with respect to macro legal issues. For example, in recent years, both the SEC and Congress have examined proxy advisors' increasing influence on corporate governance voting. During SEC and Congressional discussions there was a consensus that the increasing power of proxy advisors is the result of regulations that have significantly expanded the types of issues now subject to shareholder vote, and this has consequently increased the number of shareholder proposals subject to vote at annual shareholder meetings.[173]

The narrative in the congressional hearings of 2013 was that proxy advisors help institutional investors "determine how to vote their clients' shares on literally thousands of proxy questions companies pose each and every year."[174] The SEC followed this hearing with a roundtable discussion in December of the same year.[175] There, Michelle Edkins, Managing Director and Global Head of Corporate Governance and Responsible Investment at BlackRock, Inc., remarked, "[W]e are all under time pressure, huge time pressure. There are days when we are voting 25, 30 meetings across our team."[176] Edkins continued, "So in the U.S. we vote at about 3,700 company meetings a year. Now, globally we vote at about 15,000."[177] Similar numbers

170. INSTITUTIONAL INVESTOR ACTIVISM: HEDGE FUNDS AND PRIVATE EQUITY, ECONOMICS AND REGULATION 2 (William W. Bratton & Joseph A. McCahery eds., 2015).

171. Kahan & Rock, *supra* note 24, at 1050–54.

172. Edward B. Rock, *Institutional Investors in Corporate Governance*, *in* THE OXFORD HANDBOOK OF CORPORATE LAW AND GOVERNANCE 363, 385 (Jeffrey N. Gordon & Wolf-Georg Ringe eds., 2018).

173. *Examining the Market Power and Impact of Proxy Advisory Firms: Hearing Before the Subcomm. on Capital Mkts. & Gov't Sponsored Enters. of the H. Comm. on Fin. Servs.*, 113th Cong. 1–2 (2013).

174. *Id.* at 2.

175. SEC, Transcript of Proxy Advisory Firms Roundtable 0001 (Dec. 5, 2013) (No. 4-670), *available at* https://www.sec.gov/spotlight/proxy-advisory-services/proxy-advisory-services-transcript.txt [https://perma.cc/3622-3F2G].

176. *Id.* at 0045.

177. *Id.* at 0048. Jeffery Brown, from the Legislative and Regulatory Affairs Department of Charles Schwab, also commented, "You know, at Schwab in 2012 for the investment adviser we had 27,000 ballots and about 270,000 separate votes. Those would take an enormous amount of time for an index shop to manage if you didn't outsource that process." *Id.* at 0078.

have also been recently reported by Vanguard,[178] and State Street Global Advisors.[179]

Regulatory officials and academics have both noted the high cost to institutional investors of researching each vote they cast. In his 2014 paper, Daniel M. Gallagher, former Commissioner of the SEC,[180] explained that "[g]iven that institutional investors hold stock in hundreds or thousands of companies . . . institutional investors . . . may not be able to invest in the costly research needed to ensure that they cast each vote in the best interest of their clients."[181] On the academic side, Edward B. Rock explained that, "[w]ith the thousands of public companies held by institutional investors, each with an annual meeting and a variety of matters to vote on, voting shares is a huge task."[182] Ronald J. Gilson and Jeffrey N. Gordon also explained in their article that institutional investors "undervalue" voting as a mechanism to enhance corporate governance in companies in which they invest.[183] Finally, Serdar Çelik and Mats Isaksson of the OECD stated that "[w]ith strong economic incentives working against engagement, a mandatory voting requirement can only lead the horse to the water, but it can't make it drink."[184]

The existing criticism is to be expected given that effective voting requires institutional investors to expend enormous resources and time in conducting *individualized* company analysis—considering the specific circumstances and features of each company—with respect to issues such as executive compensation,[185] director elections,[186] and more.[187] Voting also

178. VANGUARD, INVESTMENT STEWARDSHIP 2017 ANNUAL REPORT 6 (2017), *available at* https://about.vanguard.com/investment-stewardship/annual-report.pdf [https://perma.cc/5MHD-AEHD] (reporting that Vanguard voted at 12,785 meetings in the 2015 proxy season (proxy season begins on July 1 and ends on June 30 the next year), 16,740 meetings in 2016 proxy seasons, and 18,905 in 2017 proxy season).

179. STATE STREET GLOBAL ADVISORS, 2016 YEAR END ANNUAL STEWARDSHIP REPORT 4 (2016), *available at* https://www.ssga.com/investment-topics/environmental-social-governance/2017/2016-Annual-Stewardship-Report-Year-End.pdf [https://perma.cc/59AG-WLKT] (detailing that State Street voted at 17,337 meetings in 2016 and 15,471 meetings in 2015).

180. Former Commissioner from 2011 to 2015.

181. Daniel M. Gallagher, *Outsized Power & Influence: The Role of Proxy Advisors* 4 (Wash. Legal Found., Working Paper No. 187, 2014) (footnote omitted), https://s3.us-east-2.amazonaws.com/washlegal-uploads/upload/legalstudies/workingpaper/GallagherWP8-14.pdf [https://perma.cc/W4V2-YSVX].

182. Rock, *supra* note 172, at 368.

183. Ronald J. Gilson & Jeffrey N. Gordon, *The Agency Costs of Agency Capitalism: Activist Investors and the Revaluation of Governance Rights*, 113 COLUM. L. REV. 863, 895 (2013) ("Costs, lack of expertise, and incentive conflicts reduce the value of governance rights in the hands of intermediary institutions.").

184. Çelik & Isaksson, *supra* note 23, at 111.

185. Frydman & Jenter, *supra* note 161, at 76.

186. *See supra* notes 154–55 and accompanying text.

187. As far as I know, the exact costs of proxy voting tasks have not been measured yet. However, we do have a sense of costs regarding average hedge fund activist campaigns in corporate issues. *See* Nickolay Gantchev, *The Costs of Shareholder Activism: Evidence from a Sequential*

involves the costly logistics of actually casting the votes.[188] All of these efforts are likely to be cost-prohibitive and not in line with the business model of most institutions.[189] This is especially true given that proxy voting has grown tremendously over the years,[190] and considering that, as Professor Lucian Bebchuk explains, "[w]ith respect to many issues in corporate law, deciding which arrangement is optimal is highly contestable. Furthermore, one size does not fit all: an arrangement that might be optimal for some companies might not be optimal for others."[191]

In sharp contrast, when dealing with macro legal risks, institutional investors do not need many details, and can apply more generic and formulaic models, rather than being forced to take into account company-specific circumstances. In other words, institutional investors may use, at least to a certain extent, a one-size-fits-all approach.[192] Let's take FCPA compliance as an example. Institutional investors are not required to investigate their portfolio companies' books and records that may be falsified in a sophisticated manner,[193] or to examine whether they conceal illegal payments

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Decision Model, 107 J. FIN. ECON. 610, 624 (2013) ("The cost of an activist campaign ending in a proxy contest is [estimated to cost] $10.71 million . . . .").

188. Rock, *supra* note 172, at 370 ("Simply voting the shares, without even considering *how* to vote them, is an enormous task.").

189. *Id.* at 369–71.

190. Asaf Eckstein, *Great Expectations: The Peril of an Expectations Gap in Proxy Advisory Firm Regulation*, 40 DEL. J. CORP. L. 77, 79–80 (2015).

191. Lucian Arye Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833, 869 (2005); *see also* Asaf Eckstein, *Skin in the Game for Credit Rating Agencies and Proxy Advisors: Reality Meets Theory*, 7 HARV. BUS. L. REV. 221, 257–58 (2017) ("There is no consensus among market observers and academics regarding the correct manner in which to resolve some of the most significant corporate governance issues, including which proxy advisory firms give voting recommendations."); Dorothy S. Lund, *The Case Against Passive Shareholder Voting*, 43 J. CORP. L. 493, 495 (2018) ("[W]ithout a consensus about what constitutes good governance, there is reason to believe that the proliferation of an unthinking, one-size-fits-all approach to governance will make many companies worse off.").

192. It is worth noting that BlackRock, for example, acknowledges that:

> Unlike company-specific engagement, however, public policy engagement has the potential to extend company best practices to an entire industry or market, and to establish uniform standards. It also enables investors to address market structure, practices and transparency issues that can create systemic risks for financial markets and the economy overall, such as those exposed by the global financial crisis or posed by climate change.

BLACKROCK, 21ST CENTURY ENGAGEMENT: INVESTOR STRATEGIES FOR INCORPORATING ESG CONSIDERATIONS INTO CORPORATE INTERACTIONS 32 (2015), *available at* https://www.blackrock.com/corporate/en-hu/literature/publication/blk-ceres-engagementguide2015.pdf [https://perma.cc/VNG7-4JSD] [hereinafter BLACKROCK, 21ST CENTURY ENGAGEMENT].

193. *See, e.g.*, Deferred Prosecution Agreement, *supra* note 164, at A-23 ("Teva Mexico described these improper payments, funded through the provision of the additional 2% margin to Mexican Company, as legitimate reductions of revenue in its books and records."); Complaint at 1–2, 16, SEC v. Eli Lilly & Co., No. 1:12-CV-02045 (D.D.C. 2012) (describing how Eli Lilly disguised illegal payments by falsifying the books. For example, "money that was described in

to government officials.[194] Instead, they may use a more generic approach, i.e., invite an audit to be performed in the companies' subsidiaries operating in risky industries and countries; require companies to develop and adopt anti-corruption policies that include prohibitions on providing anything of value to a government official; develop mechanisms for approval of agreements with risk for corruption (such as consulting agreements); ensure proper record keeping;[195] establish an effective system for reporting suspected criminal conduct and violations of the compliance policies and standards; require companies to be aware of factors that have already been identified by the DOJ as "red flags" and warrant significant scrutiny;[196] order periodic testing of the compliance code, standards, and procedures designed to evaluate their effectiveness in detecting and reducing violations of anti-corruption laws; require companies to appoint professional officials to supervise and implement such a policy;[197] and ensure that employees receive training and education.[198] Similarly, in order to enhance companies' compliance regarding anti-money laundering, institutional investors can rely on existing lists of money laundering red flags (formulated by regulators such as the Federal Deposit Insurance Corporation) to make sure that companies institute mechanisms aimed at identifying and dealing with such red flags.[199]

company records as a 'discount' for a pharmaceutical distributor was, in actuality, a bribe for government officials."); Deferred Prosecution Agreement with Johnson & Johnson at 28, United States v. Depuy, Inc., No. 1:11-CR-00099-JDB (D.D.C. 2011), *available at* https://www.justice.gov/sites/default/files/criminal-fraud/legacy/2011/04/27/04-08-11depuy-dpa.pdf [https://perma.cc/CZ4A-TUPQ] (describing how in order to disguise illegal payments to health care providers on the books and records of J&J, the payments were misrepresented as "'commissions,' 'civil contracts,' 'travel,' 'donations,' and 'discounts'").

194. *Anti-Corruption Policy*, FRANKLIN TEMPLETON, https://www.franklintempleton.com/investor/help/anti-corruption [https://perma.cc/WH8B-CTW4].

195. *Id.*

196. Matteson Ellis, *Ten FCPA Compliance Tips for Private Equity*, FCPAMÉRICAS (Feb. 27, 2015), http://fcpamericas.com/english/anti-corruption-compliance/ten-fcpa-compliance-tips-private-equity [https://perma.cc/X6TA-MDKZ] ("The firm must also prepare its own deal people, the ones who sit on portfolio company boards, analyze business trends, and have regular contact with portfolio company managers, to spot FCPA red flags and evaluate compliance efforts."). For a description of "red flags" specific to the FCPA context, as identified by the DOJ and the SEC, see LANNY A. BREUER & ROBERT S. KHUZAMI, U.S. DEP'T OF JUSTICE & SEC, FCPA: A RESOURCE GUIDE TO THE U.S. FOREIGN CORRUPT PRACTICES ACT 22–24 (2012).

197. Ellis, *supra* note 196 ("Private equity firms will want to ensure that each portfolio company has an individual chief compliance officer (CCO) in place who is responsible for program design and implementation.").

198. *Id.* ("It is highly likely that most companies within a portfolio will face at least some common types of FCPA risks, especially for private equity firms that specialize in specific industries and sectors. To provide enhanced training in these risk areas, private equity firms can organize webinars that CCOs, general counsel, and other executives and managers of portfolio companies can attend.").

199. *See, e.g.*, Fed. Deposit Ins. Corp., *Bank Secrecy Act, Anti-Money Laundering, and Office of Foreign Assets Control*, *in* RISK MANAGEMENT MANUAL OF EXAMINATION POLICIES 8.1-1, 8.1-39 to -44 (2005), *available at* https://www.fdic.gov/regulations/safety/manual/section8-1.pdf [https://

Such a unified approach is likely to impose lower costs on institutional investors, and allow them to enjoy economies of scale.

Recall that concerns about the antitrust implications of common ownership focus on the *aggregate* power of institutional investors, allowing them to lessen competition.[200] However, as a mirror image of this concern, *aggregation* may actually drive institutions to more effectively monitor portfolio companies. As explained by Marcel Kahan and Edward B. Rock, institutional investors enjoy economies of scale. Given that they own shares in a larger number of companies, costs related to corporate governance activities that are common for several companies can be spread over a larger number of investments.[201] This is likely to be especially true regarding institutional investors engagement with macro legal risks that by their very nature have relevance to entire industries.

Moreover, when responding to macro legal risks, such as corruption, the ability of institutional investors to convince management teams to follow laws and regulations, and accordingly to implement appropriate controls, is likely to be high. This is because these issues are less contestable than other classic issues of corporate governance, i.e., the line between legal and illegal conduct is relatively visible, verifiable and more obvious.[202] Thus, institutions are more likely to successfully persuade management teams to obey industry-applicable law and regulations than they are to persuade them when dealing with firm-specific issues such as executive compensation, nomination of directors, and other issues that are highly contestable, or soft idiosyncratic issues that are less observable.[203] Similarly, issues related to macro legal risks, by their very nature, are much less contestable in the eyes of management teams in which institutions invest. For example, a large institutional investor requiring companies to strengthen compliance mechanisms in a certain way to deal with risk exposure in certain industry, is not very likely to attract the opposition of managers. This may also make institutional investors more active when dealing with macro legal risks, unlike other corporate issues that are likely to be more divisive.[204]

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perma.cc/NR9P-RQN2]; FIN. ACTION TASK FORCE, FATF GUIDANCE: ANTI-MONEY LAUNDERING AND TERRORIST FINANCING MEASURES AND FINANCIAL INCLUSION 40–41 (2013), *available at* https://www.fatf-gafi.org/media/fatf/documents/reports/AML_CFT_Measures_and_Financial_Inclusion_2013.pdf [https://perma.cc/QFX2-6C98].

200. *See supra* Part III.

201. Kahan & Rock, *supra* note 24, at 1048.

202. *See, e.g.*, Norm Champ, *Building Effective Relationships with Regulators*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Oct. 22, 2015), https://corpgov.law.harvard.edu/2015/10/22/building-effective-relationships-with-regulators [https://perma.cc/3RCG-WGDG] (asserting that "avoiding an SEC Enforcement civil action, or worse, a criminal action from the Department of Justice," is typically "a non-controversial goal for [a] firm").

203. *See* discussion *supra* Part IV.

204. In this regard, see Bebchuk et al., *supra* note 167, at 101–04 (explaining how investment managers are likely to be reluctant to "tak[e] positions that corporate managers disfavor." If they

Finally, the combination of common ownership and the low cost of identifying and responding to macro legal risk, is likely to mitigate free-rider concerns. Historically, activist investors believed they were facing a free-rider problem when considering intervention in investment companies. This is because the activist institution received only a portion of the benefit resulting from their efforts (according to their proportional holdings) while bearing the full cost of researching matters subject to voting, as well as other associated costs.[205]

However, common ownership is likely to reduce the free-rider concern. If BlackRock holds ten percent of a single company, it may be concerned with the free-rider problem (that it will only gain ten percent of the benefit while investing 100 percent of the resources researching the matter) and therefore choose to stay passive. However, if it holds ten percent of ten companies that operate within the same industry and are subject to a *common* legal risk, then BlackRock's *aggregate* holding size is likely to push it to be more active because the benefit from engagement is likely to be much higher and outweigh free-rider concerns.[206] Put differently, common ownership structure reflects an

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do take such positions, they may bear private costs); Lucian Arye Bebchuk, *The Case for Shareholder Access to the Ballot*, 59 BUS. LAW. 43, 50 (2003) (arguing that money managers "would wish to avoid any risk of litigation or company retaliation"); and Lucian Bebchuk & Scott Hirst, *Index Funds and the Future of Corporate Governance: Theory, Evidence, and Policy* 28 (European Corp. Governance Inst., Working Paper No. 433, 2018) (arguing that intervention of institutional investors "by (i) making executive compensation incentives more tightly linked to performance, (ii) eliminating anti-takeover defenses, (iii) monitoring the business performance of CEOs very closely, and (iv) forcing out CEOs who do not meet a relatively standard of performance . . . would create a significant risk of a backlash" because "managers of portfolio companies would have strong incentives to resist it and mobilize against the Big Three because of the [intervention's] adverse effect on their power and private interests").

205. *See* Anat R. Admati et al., *Large Shareholder Activism, Risk Sharing, and Financial Market Equilibrium*, 102 J. POL. ECON. 1097, 1100 (1994) ("[The] problem arises because small and passive shareholders realize the benefits of monitoring done by large shareholders but they incur none of the costs."); Lucian A. Bebchuk & Zvika Neeman, *Investor Protection and Interest Group Politics*, 23 REV. FIN. STUD. 1089, 1091 (2010) (explaining that "institutional investors can be expected to invest less in lobbying against weak investor protection than would be optimal for the class of outsider investors as a whole," because they would "bear the costs of lobbying" themselves, i.e., without sharing the costs with the company, while "captur[ing] only part of the benefits to outside investors resulting from improved investor protection"); *see also* OECD, THE ROLE OF INSTITUTIONAL INVESTORS IN PROMOTING GOOD CORPORATE GOVERNANCE 9–10 (2011), *available at* https://www.oecd.org/daf/ca/49081553.pdf [https://perma.cc/QU86-WMUA] (pointing to the free-rider problem as a possible explanation of the passivity of institutional investors); John C. Coffee, Jr., *Liquidity Versus Control: The Institutional Investor as Corporate Monitor*, 91 COLUM. L. REV. 1277, 1285 (1991) (evaluating "the dangers in uniting liquidity and control").

206. Andrei Shleifer & Robert W. Vishny, *Large Shareholders and Corporate Control*, 94 J. POL. ECON. 461, 463–65 (1986) (modeling the blockholder's free-rider problem); *see also* Bernard S. Black, *Agents Watching Agents: The Promise of Institutional Investor Voice*, 39 UCLA L. REV. 811, 821–22 (1992) ("A shareholder who owns a large percentage stake is more likely to engage in monitoring than a shareholder who owns a smaller stake.").

aggregation of institutions' holding size, and therefore reduces free-riding concerns.[207]

Before proceeding, one possibility deserves further discussion. So far, I have explained that institutional investors can respond to macro legal risks and drive managers of their portfolio companies to behave appropriately —with relatively low costs. Interestingly, it is likely that the mere common ownership structure may provide managers of portfolio companies with unilateral incentives to be more aware and to better respond to macro developments, even without institutions' active intervention. If BlackRock, for example, has a stake in firms A, B, C, and D, and firms A and B are investigated by the DOJ, this might deter firms C and D from committing a similar wrongdoing. Firms C and D are aware that "big brother" BlackRock has become aware of the FCPA issues, for example, and it is not in their best interest to behave in a way that might attract a similar investigation or intrusion from the institutional investor. In this way, companies may have an increased incentive to monitor themselves, in addition to the monitoring mechanisms an institutional investor might be incentivized to put in place.

In an effort to simplify the foregoing discussion, this Article provides the following Table which identifies the relevant considerations discussed above in Part IV and Section V.A regarding institutional investors' incentives in monitoring the way companies in which they invest comply with laws and regulations. Table 1 compares this to investors' involvement in traditional corporate voting and activities.

207. This is not to say that common ownership would eliminate free-rider concerns because, still, if one institution invests efforts in dealing with legal risks, other institutions are likely to enjoy the benefits from it. But, again, the cost of dealing with macro legal risks is not high as the cost of activities aiming to deal with classic governance issues (such as executive compensation, director elections, etc.). Therefore, it is the combination of common ownership and the low cost of dealing with macro legal risks that alleviate the free-rider concern.

Table 1. Incentives to Monitor Firms' Compliance with Law vs. Incentives to Engage in Traditional Corporate Issues

Considerations	**Compliance**	**Traditional Issues**
Verifiability (affects the ease by which investors are able to monitor firms in which they invest)	High	Medium
Generic Model to Monitor Firms (rather than firm-specific analysis)	Applicable	Non-Applicable
Contestability (the level of disagreement regarding the issue)	Low	High
Likelihood of Attracting Managers Opposition	Low	Medium - High
Free-Rider Concerns	Low	High

2. Aggregate Risk and Costs Associated with Being Penalized

Today, the risk of being subjected to criminal and civil enforcement is quite high and affecting industry practice. There are two major reasons for this. First and foremost, in recent years, the DOJ and its colleagues have invested major efforts to detect and prosecute companies for the violation of criminal laws, such as FCPA and antitrust.[208] Second, many offenses that are interconnected and exemplify macro legal risks are easily recognizable to managers and employees who can quickly report them to the DOJ. For example, in the famous Wal-Mart case, a former executive of Wal-Mart's Mexican subsidiary, Wal-Mart de Mexico ("Wal-Mex"), "tired of the '"pressure and stress" of participating in years of corruption' and resentful of being snubbed for a promotion," reported the "financial '"irregularities" authorized "by the highest levels" at Wal-Mex.'"[209] Whistleblowing has become a prevalent tool for enforcement authorities. In fiscal year 2016, the SEC received 4,200

208. *See supra* Section III.A.

209. Cottrell *ex rel.* Wal-Mart Stores, Inc. v. Duke, 829 F.3d 983, 986 (8th Cir. 2016).

tips from whistleblowers,[210] and 238 of these complaints were made about FCPA violations.[211] Whistleblowers play an even more prominent role regarding FCA violations. Recall, the DOJ announced that it recovered over $3.7 billion from FCA violations in 2017.[212] Of those recoveries, $3.4 billion (92 percent) were recovered through cases initiated by whistleblowers.[213] The DOJ paid $392 million in whistleblower awards over the course of the year.[214] Third, and more specific to the context of macro legal risks, many cases are interconnected, and thus once the DOJ or the SEC detect one company, it may lead them to detect other companies that are involved in the same affair.[215]

Once detected, corporate criminal conduct may have dramatic negative implications. This often begins with a criminal investigation commenced by the DOJ and its colleagues, mainly the SEC. Investigations of corporate wrongdoing can take years to complete. It was recently reported that "4.25 years was the median length of time companies that resolved FCPA enforcement actions in 2016 were under scrutiny,"[216] and according to the General Accounting Office report, the investigation of certain FCPA violations "could take up to 10 years."[217]

To resolve the criminal cases, companies pay huge fines, usually through Deferred Prosecution Agreements or Non-Prosecution Agreements (collectively termed Pretrial Diversion Agreements ("PDAs")). To illustrate, the companies that make up the FCPA's "top ten list" paid, altogether, more than five billion dollars in penalties, an average of over $500 million per company.[218] Government enforcement also triggers collateral civil actions

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210. SEC, 2016 ANNUAL REPORT TO CONGRESS ON THE DODD–FRANK WHISTLEBLOWER PROGRAM 1 (2016), *available at* https://www.sec.gov/files/owb-annual-report-2016.pdf [https://perma.cc/YA54-BS8K].

211. *Id.* at 31.

212. Press Release, U.S. Dep't of Justice, *supra* note 76. As Principal Deputy Assistant General Benjamin C. Mizer pointed out, "The *qui tam* provisions provide a valuable incentive to industry insiders who are uniquely positioned to expose fraud and false claims to come forward despite the risk to their careers." Press Release, U.S. Dep't of Justice, *supra* note 75.

213. Press Release, U.S. Dep't of Justice, *supra* note 76.

214. *Id.*

215. Within the FCPA context, see, e.g., Rubenfeld & Palazzolo, *supra* note 73.

216. *The Gray Cloud of FCPA Scrutiny Lasted Too Long in 2016*, FCPA PROFESSOR (Jan. 6, 2017), http://fcpaprofessor.com/gray-cloud-fcpa-scrutiny-lasted-long-2016 [https://perma.cc/6FDD-T2SD].

217. U.S. GOV'T ACCOUNTABILITY OFF., GAO-09-636T, CORPORATE CRIME: PRELIMINARY OBSERVATIONS ON DOJ'S USE AND OVERSIGHT OF DEFERRED PROSECUTION AND NON-PROSECUTION AGREEMENTS 9 (2009), *available at* https://www.gao.gov/assets/130/122853.pdf [https://perma.cc/X92P-TJA9] (statement of Eileen R. Larence, Director, Homeland Security and Justice).

218. Richard L. Cassin, *DOJ Reduces Odebrecht Penalties, We Revise the Top Ten List*, FCPA BLOG (Apr. 14, 2017, 7:28 AM), http://www.fcpablog.com/blog/2017/4/14/doj-reduces-odebrecht-penalties-we-revise-the-top-ten-list.html [https://perma.cc/M6DZ-RFPJ].

brought by private plaintiffs.[219] Companies embroiled in corruption scandals can also be excluded from potential governmental projects.[220] For example, in the FCPA context, Siemens' scandal resulted in a two-year World Bank debarment;[221] news of this debarment had an "immediate effect of reducing Siemens' share price by 5%."[222] Similarly, Alstom's FCPA scandal resulted in a three-year World Bank debarment.[223]

Furthermore, many PDAs include imposition of expensive compliance programs and an external corporate compliance monitor.[224] As illustrated by Jennifer Arlen and Marcel Kahan, from 2008 to 2014, approximately 82 percent of the PDAs (152 out of 185) entered into by the DOJ Criminal Division or the U.S. Attorneys' Offices imposed compliance program mandates, and 31 percent (58 out of 185) imposed outside monitors.[225]

Hiring such outside monitors can be expensive. For example, former Attorney General John Ashcroft was appointed in 2008 to be the monitor of Zimmer, Inc., a medical supply company accused of giving kickbacks to doctors.[226] The company awarded Ashcroft an 18-month contract worth $28

219. Amy Deen Westbrook, *Double Trouble: Collateral Shareholder Litigation Following Foreign Corrupt Practices Act Investigations*, 73 OHIO ST. L.J. 1217, 1224–27 (2012).

220. Court E. Golumbic & Albert D. Lichy, *The "Too Big to Jail" Effect and the Impact on the Justice Department's Corporate Charging Policy*, 65 HASTINGS L.J. 1293, 1313–14 (2014) (demonstrating the collateral consequences of the Arthur Andersen investigation and indictment); Christopher A. Wray & Robert K. Hur, *Corporate Criminal Prosecution in a Post-Enron World: The Thompson Memo in Theory and Practice*, 43 AM. CRIM. L. REV. 1095, 1165 (2006) (explaining how health care companies are subject to "the risk of exclusion from federal health care programs"); Benjamin M. Greenblum, Note, *What Happens to a Prosecution Deferred? Judicial Oversight of Corporate Deferred Prosecution Agreements*, 105 COLUM. L. REV. 1863, 1885 (2005) (explaining that corporations convicted of a felony "can be debarred from government contracting and have their professional licenses revoked").

221. Press Release, The World Bank, Siemens to Pay $100 Million to Fight Fraud and Corruption as Part of World Bank Group Settlement (July 2, 2009), *available at* http://www.worldbank.org/en/news/press-release/2009/07/02/siemens-pay-million-fight-fraud-corruption-part-world-bank-group-settlement [https://perma.cc/LT3D-G4XL].

222. George Dallas, *Corrupt Practices*, *in* ICGN YEARBOOK 2010, at 50, 51 (Kevin Eddy ed., 2010), *available at* http://bettergovernance.com.br/Uploads/Docs/AR16032011-76993.pdf [https://perma.cc/CTS2-KCAP].

223. Press Release, The World Bank, Enforcing Accountability: World Bank Debars Alstom Hydro France, Alstom Network Schweiz AG, and Their Affiliates (Feb. 22, 2012), *available at* https://www.worldbank.org/en/news/press-release/2012/02/22/enforcing-accountability-world-bank-debars-alstom-hydro-france-alstom-network-schweiz-ag-and-their-affiliates [https://perma.cc/G5EJ-U4GQ].

224. Vikramaditya Khanna & Timothy L. Dickinson, *The Corporate Monitor: The New Corporate Czar?*, 105 MICH. L. REV. 1713, 1720–26 (2007) (discussing corporate-monitor provisions in PDAs).

225. Jennifer Arlen & Marcel Kahan, *Corporate Governance Regulation Through Nonprosecution*, 84 U. CHI. L. REV. 323, 343 tbl.1 (2017).

226. Deferred Prosecution Agreement at 1–6, United States v. Zimmer Biomet Holdings, Inc., No. 12-CR-00080-RBW (D.D.C. Jan. 13, 2017), *available at* http://lib.law.virginia.edu/Garrett/corporate-prosecution-registry/agreements/zimmer-biomet-2017.pdf [https://perma.cc/97TV-JJ3J] [hereinafter Deferred Prosecution Agreement, United States v. Zimmer Biomet Holdings, Inc.]; Nina Totenberg, *House Panel Questions Ashcroft on No-Bid Contract*, NAT'L PUB.

million to $52 million.[227] Another example is oilfield services giant Baker Hughes, Inc. In 2007, the DOJ and the SEC cases against Baker Hughes settled and the company was ordered to pay penalties and disgorgement of approximately $44 million.[228] In addition to the penalties, however, Baker Hughes reportedly also spent more than $50 million on an internal investigation and agreed to engage a monitor.[229]

Beyond their direct costs, investigations and settlements usually lead to reputational loss for the company. A famous study led by Jonathan Karpoff examined 585 companies that were disciplined by the SEC and the DOJ for financial misrepresentation from 1978 through 2002.[230] This study revealed that these companies lose 38 percent of their market value after news of their misconduct was reported.[231] Relatedly, interventions of outside monitors and legal proceedings divert significant senior management time away from running the business.[232]

Institutional investors whose holdings are based on common ownership, therefore, can benefit tremendously. Since the violations of one company should be similar to the other companies within the same industry, through common ownership institutions can respond to all violations of the same type at once, rather than individually. This can save them from some of the very serious penalties described in this Section.

3. Examples and Illustrations

This part of the Article aims to support the theoretical discussion above by providing examples and illustrations of the way large institutional investors engage in corporate governance issues that are relevant to entire industries.

RADIO (Mar. 12, 2008, 6:00 AM), https://www.npr.org/templates/story/story.php?storyId=88132206 [https://perma.cc/645Y-26MR].

227. Philip Shenon, *Ashcroft Deal Brings Scrutiny in Justice Dept.*, N.Y. TIMES (Jan. 10, 2008), https://www.nytimes.com/2008/01/10/washington/10justice.html [https://perma.cc/5LCG-C745].

228. Nick Snow, *Baker Hughes to Pay Record $44 Million to Settle FCPA Charges*, OIL & GAS J. (Apr. 27, 2007), https://www.ogj.com/general-interest/article/17287513/baker-hughes-to-pay-record-44-million-to-settle-fcpa-charges [https://perma.cc/YJ2J-Z6N9].

229. Nathan Vardi, *How Federal Crackdown on Bribery Hurts Business and Enriches Insiders*, FORBES (May 6, 2010, 5:40 PM), https://www.forbes.com/forbes/2010/0524/business-weatherford-kbr-corruption-bribery-racket.html [https://perma.cc/H2MZ-P67T].

230. *See generally* Jonathan M. Karpoff et al., *The Cost to Firms of Cooking the Books*, 43 J. FIN. & QUANTITATIVE ANALYSIS 581 (2008) (detailing study on 585 firms).

231. *Id.*; Jonathan M. Karpoff, *Does Reputation Work to Discipline Corporate Misconduct?*, *in* THE OXFORD HANDBOOK OF CORPORATE REPUTATION 361–63 (Michael L. Barnett & Timothy G. Pollock eds., 2012) (providing a survey of the evidence on reputational losses for different types of corporate misconduct).

232. *See, e.g.*, MIKE KOEHLER, THE FOREIGN CORRUPT PRACTICES ACT IN A NEW ERA 277 (2014) (explaining how "FCPA scrutiny can also be distracting for company management forced to focus on FCPA issues instead of other core business issues," and using the Wal-Mart and RAE cases as examples).

Because institutional investors' engagement with companies in which they invest often occurs behind the scenes,[233] there are not many examples of engagements related to macro legal risks. Still, it is clear that engagements regarding oversight of macro legal risks do occur and even constitute a top priority of institutional investors during recent years.[234] It is useful to refer to some examples that are available.

First, in its 2012 corporate responsibility report, State Street, one of the largest institutional investors in the world, stated that "[e]xternal events often drive the environmental and social issues that emerge frequently during our discussions with issuing companies. In 2012, many issuer engagement sessions focused on bribery and corruption, largely as a result of the [U.K.] Bribery Act and the [U.S.] Foreign Corrupt Practices Act."[235] In its 2015 annual stewardship report, State Street's investment management arm, State Street Global Advisors ("SSGA"), one of the largest investors in the world in its own right, revealed that its 2015 engagement efforts were driven by eight stewardship priorities, including "[b]ribery and corruption."[236] SSGA explained that it focused on the pharma sector and engaged with 48 individual companies.[237]

Similarly, Vanguard has recently engaged with holding companies who have committed fraud, in an effort to "[hold] board members accountable."[238] In an instance of fraud in a U.S. financial company, Vanguard "questioned a key committee's ability to fulfill its obligations to implement an effective risk oversight structure [and] [b]ased on [their] engagement, . . . concluded that certain directors had fallen short of their responsibility to understand the risks and culture of the company and to

233. Lucian A. Bebchuk & Michael S. Weisbach, *The State of Corporate Governance Research*, 23 REV. FIN. STUD. 939, 942 (2010) ("Unfortunately, informal contact between institutional investors and firms is by its nature private and difficult to quantify. Consequently, there has historically been only one study of such activism . . . ."); Mallow & Sethi, *supra* note 20, at 396 ("Engagement often occurs privately—away from the scrutiny of the public and the media—and it is less measurable than a shareholder vote."); *see also* John C. Wilcox, *Getting Along with BlackRock*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Nov. 6, 2017), https://corpgov.law.harvard.edu/2017/11/06/getting-along-with-blackrock [https://perma.cc/H5XM-5NB5] ("[BlackRock] prefers private dialogue over public action.").

234. Recently released surveys reveal that directors increasingly meet with institutional investors specifically to discuss risk oversight, a subject of increasing interest for investors. Lipton et al., *supra* note 13.

235. STATE ST. GLOB. ADVISORS, CORPORATE RESPONSIBILITY 2012 REPORT: BUILDING A BETTER BUSINESS 45 (2012), *available at* http://www.statestreet.com/content/dam/statestreet/documents/values/2012_CR_Report.pdf [https://perma.cc/L2TH-84PV].

236. STATE ST. GLOB. ADVISORS, ANNUAL STEWARDSHIP REPORT 2015 YEAR END 15 (2016), *available at* https://www.ssga.com/investment-topics/environmental-social-governance/2016/2015-Annual-Stewardship-Report.pdf [https://perma.cc/EG7J-H576].

237. *Id.*

238. VANGUARD, INVESTMENT STEWARDSHIP 2017 ANNUAL REPORT 23 (2017), *available at* https://about.vanguard.com/investment-stewardship/annual-report.pdf [https://perma.cc/TNX3-F5SX].

challenge management when necessary . . . ."[239] Vanguard voted against the reelection of the board members in question, and although they were narrowly reelected, "the company has since announced a series of changes at the board level that are responsive to many concerns expressed by shareholders."[240] Finally, Vanguard just recently "voted against three directors at Wells Fargo & Co . . . , including Chairman Stephen Sanger," after the financial company was fined for fraud.[241] Once Vanguard is aware of this type of fraud in one company, they should be better equipped to prevent it in other companies they invest in, due to their common ownership position.[242]

In a similar manner, BlackRock's 2018 Investment Stewardship Report points out that during 2018, BlackRock's focus of engagement was on "[g]overnance," with 728 engagements in the Americas.[243] As BlackRock explains, it engages with companies for "five main reasons," one of them is the fact that "[t]he company is in a sector or market where there is a thematic governance issue material to shareholder value."[244] As BlackRock further elaborated, "When events occur that have the potential to impact all companies in a sector we aim to engage with all of those companies to understand how the event or reactions to it may affect the long-term value of

239. *Id.*

240. *Id.*

241. Ross Kerber, *Vanguard Withheld Support for Key Wells Fargo Directors: Filings*, REUTERS (Aug. 31, 2017, 4:32 PM), https://www.reuters.com/article/us-wellsfargo-accounts-vanguard-idUSKCN1BB33D [https://perma.cc/F77L-NZUY].

242. On this point, it is interesting to note that in a 2015 letter to hundreds of public companies, F. William McNabb III, chairman and CEO of Vanguard, declared that, "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." *See* Kirsten Grind & Joann S. Lublin, *Vanguard and BlackRock Plan to Get More Assertive with Their Investments*, WALL ST. J. (Mar. 4, 2015, 12:00 AM), https://www.wsj.com/articles/vanguard-and-blackrock-plan-to-get-more-assertive-with-their-investments-1425445200 [https://perma.cc/8JGU-ZHB2].

243. BLACKROCK, INVESTMENT STEWARDSHIP REPORT: 2018 VOTING AND ENGAGEMENT REPORT JULY 1, 2017–JUNE 30, 2018, at 3 (2018), *available at* https://www.blackrock.com/corporate/literature/publication/blk-voting-and-engagment-statistics-annual-report-2018.pdf [https://perma.cc/Q9U2-AZW4].

244. *Id.*; *see also* BLACKROCK, BLACKROCK INVESTMENT STEWARDSHIP: PROTECTING OUR CLIENTS' ASSETS FOR THE LONG-TERM 8–9 (2019), *available at* https://www.blackrock.com/corporate/literature/publication/blk-profile-of-blackrock-investment-stewardship-team-work.pdf [https://perma.cc/4582-6B8H] ("How we identify companies for engagement . . . We also consider events that have impacted or may impact long-term shareholder value, and the management of *sector-specific concerns*, which are also material to long-term shareholder value." (emphasis added)); *id.* at 9 ("Additionally, BlackRock's investment teams leverage qualitative and quantitative company information, as well as *sector and industry research* . . . ." (emphasis added)); *id.* at 13 ("Our voting process . . . How an investment stewardship team analyst decides to vote[:] The team votes at over 17,000 meetings a year, which are initially allocated by region. . . . Each regional universe is then subdivided again, either by market or sector.").

our clients' assets."[245] From time to time, BlackRock even published examples of its engagements in certain sectors, such as the pharmaceutical and energy sectors.[246] In fact, the BlackRock Investment Stewardship team is composed of sector analysts.[247] And, in order to understand "precisely which [environmental, sustainability and governance] factors are most critical to a particular company," BlackRock suggests using an "industry-based or sector-based approach."[248] BlackRock also demonstrates how to do it with regard to other sectors such as Oil, Gas and Mining; Banking and Finance; Insurance; Healthcare and Pharmaceuticals; etc.[249]

More specifically, as BlackRock's 2016 report demonstrates, BlackRock follows sustainability standards that identify material issues across different industries and sectors.[250] For example, regarding the Healthcare industry, the focus has been put on "[b]usiness ethics and transparency of payments;" whereas, when it comes to the financials industry, the emphasis is on "[f]air marketing and advertising."[251] For the "Technology and Communications" industry, the focus is on "[d]ata security and customer privacy."[252] Lastly, in her testimony at the recent FTC hearing on common ownership, Barbara Novick, Vice Chairman at BlackRock, explained how BlackRock has monitored the way pharmaceutical companies that manufacture opioids, comply with existing industry-specific laws.[253] In a similar manner, BlackRock's rival, Fidelity, released in August 2016 a report discussing its

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245. BLACKROCK, BLACKROCK INVESTMENT STEWARDSHIP: 2018 ANNUAL REPORT 14 (2018), *available at* https://www.blackrock.com/corporate/literature/publication/blk-annual-stewardship-report-2018.pdf [https://perma.cc/G46P-MCB9] ("Our EMEA Stewardship team engaged extensively with companies in the real estate, hospitality, and pharmaceuticals industries on various sector-specific strategic challenges.").

246. *See, e.g.*, BLACKROCK, THE INVESTMENT STEWARDSHIP ECOSYSTEM 7–8 (2018), *available at* https://www.blackrock.com/corporate/literature/whitepaper/viewpoint-investment-stewardship-ecosystem-july-2018.pdf [https://perma.cc/W9C3-JXVL].

247. BLACKROCK, INVESTMENT STEWARDSHIP REPORT: AMERICAS Q1 2018, at 8 (2018), *available at* https://www.blackrock.com/corporate/literature/publication/blk-qtrly-commentary-2018-q1-amers.pdf [https://perma.cc/4KR6-89KZ] ("Michelle Edkins, BlackRock's Global Head of Investment Stewardship, introduced the Americas team, and each sector analyst discussed developments in their specific coverage areas.").

248. BLACKROCK, 21ST CENTURY ENGAGEMENT, *supra* note 192, at 48.

249. *Id.* at 49–52.

250. BLACKROCK, EXPLORING ESG: A PRACTITIONER'S PERSPECTIVE 6 (2016), *available at* https://www.blackrock.com/corporate/literature/whitepaper/viewpoint-exploring-esg-a-practitioners-perspective-june-2016.pdf [https://perma.cc/ET9L-Y6DK].

251. *Id.*

252. *Id.*

253. Barbara Novick, *Remarks at FTC Hearing on Competition and Consumer Protection in the 21st Century*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Jan. 22, 2019), https://corpgov.law.harvard.edu/2019/01/22/remarks-at-ftc-hearing-on-competition-and-consumer-protection-in-the-21st-century [https://perma.cc/MD8H-BRJV].

environmental, social, and government policy.[254] As the report reflects, Fidelity teams may consider as part of their company and industry analysis various factors, including "[c]hanges to regulation" and "bribery and corruption."[255] Finally, new research by Morningstar that examined the 12 largest index funds in the United States, Europe, and Asia concluded that index managers are increasingly committed to using their tools of proxy voting and engagement to enhance environmental, social and governance ("ESG") activities of their holdings.[256] The relatively new trend of ESG means that firms in which large institutional investors invest are expected by large institutional investors to target not only profits and returns, but also to contribute to the prosperity and security of society as a whole.[257] Compliance to laws and regulations that are at the heart of this Article and specifically discussed in Part III of this Article, is likely to enhance the ESG goals.

4. Summing Up

In summation, institutional investors are rational players. As such, they compare the potential costs of a course of action with the potential benefits.[258] In our case, the potential costs of identifying the macro legal trends or patterns and accordingly informing, warning and requiring portfolio companies to adopt "best practices" to minimize risky behavior or wrongdoing, are not high. This is due to the nature of macro legal risks and the common ownership structure that allows these costs to be divided over a large number of companies with similar features. The potential benefits come from the high probability of the success of institutions to minimize wrongdoing and to prevent severe consequences. Institutional investors have already begun to benefit from common ownership. Common ownership has

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254. FIDELITY INT'L, ENVIRONMENTAL, SOCIAL AND GOVERNANCE POLICY 3 (2016), *available at* https://www.fidelity.co.uk/static/pdf/common/footer/esg-policy.pdf [https://perma.cc/77FW-VZLL].

255. *Id.* at 5. As the report explains, Fidelity uses "three types of ESG-related research reports," including "industry-specific reports." *Id.* at 6.

256. MIKE LASKE, MORNINGSTAR, PASSIVE FUND PROVIDERS TAKE AN ACTIVE APPROACH TO INVESTMENT STEWARDSHIP 1–2 (2017), *available at* https://www-prd.morningstar.com/content/dam/marketing/shared/pdfs/Research/Morningstar-Passive-Active-Stewardship.pdf?cid=EMQ_&utm_source=eloqua&utm_medium=email&utm_campaign=&utm_content=17615 [https://perma.cc/K56E-HZZD].

257. *See, e.g.*, Larry Fink, *Larry Fink's 2018 Letter to CEOs: A Sense of Purpose*, BLACKROCK (2018), https://www.blackrock.com/hk/en/insights/larry-fink-ceo-letter ("Today, our clients—who are your company's owners—are asking you to demonstrate the leadership and clarity that will drive not only their own investment returns, but also the prosperity and security of their fellow citizens.").

258. Pozen, *supra* note 169; *see also* Gilson & Gordon, *supra* note 183, at 867, 887 (suggesting that although institutional investors "are not proactive, they are not passive in the Berle-Means sense," but rather they "are 'rationally reticent' . . . will[ing] to respond to proposals but are unlikely to [propose] them").

the potential to further increase incentives of institutional investors to monitor companies regarding macro legal risks.

It is important to add that in the context of common ownership, institutional investors often do not have a viable exit option.[259] Recall, the rise of common ownership is primarily associated with the rise of passive index funds.[260] And, given that index funds cannot sell their holdings or individual companies in a practical manner, they are likely to exert their power to use their voice, through voting or engagements.[261]

B. PRIVILEGED ACCESS TO POLICYMAKING

Common ownership provides institutional investors with significant power, allowing them privileged access to lawmaking and rulemaking that in turn allows them to recognize upcoming trends in law and regulation, and accordingly inform, and when necessary warn, companies in which they invest against new trends in enforcement. This may be especially important given that various factors, not just pure legal factors, that affect the attitude of the relevant regulator regarding existing laws and enforcement.[262] Put differently,

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259. *See generally* ALBERT O. HIRSCHMAN, EXIT, VOICE, AND LOYALTY: RESPONSES TO DECLINE IN FIRMS, ORGANIZATIONS, AND STATES (1970) (speaking generally, institutional investors have two strategies at their disposal: "voice" and "exit"). The exit option refers to the ability of the institution to sell its holdings in companies that are performing poorly. *See id.* at 15–16. The voice option consists of the power of institution to express its opinion on the way a company is managed. *Id.* at 30. There is a tradeoff between voice and exit, in the sense that fewer exit opportunities would generate greater voice. *Id.* at 36–43.

260. Azar et al., *supra* note 2, at 25.

261. *See* NOVICK ET AL., *supra* note 51, at 8 ("The use of engagement is even more vital for index investment managers because index funds will remain invested in a stock for as long as it is included in a given index as required by the strategy on which they have agreed with asset owners. This is in contrast to an active fund that can sell a stock if its manager loses confidence in a company's future. That is why it is of particular importance for index investment managers, acting as fiduciaries to their clients, to engage with companies on issues of corporate governance and vote against management when that engagement fails."); *see also* Ronald P. O'Hanley, President & CEO, State St. Glob. Advisors, Long-Term Value Begins at the Board: The Power and Potential of Active Asset Stewardship, Speech at the Weinberg Center 2017 Corporate Governance Symposium, University of Delaware 2 (Mar. 7, 2017), *available at* https://www.ssga.com/investment-topics/environmental-social-governance/2018/03/long-term-value-begins-at-the-board.pdf [https://perma.cc/8EPB-W7UK] ("An index fund is essentially permanent capital. Unlike active managers, we can't walk away from a company so long as it is in the index."). Finally, Jack Bogle, the Vanguard founder, explained in an interview that "[t]he old Wall Street rule was, 'If you don't like the management, sell the stock.' The index funds can't follow that rule, so there's only one rule left: 'If you don't like the management, fix it.'" *See* Michael Regan, *Q&A with Jack Bogle: 'We're in the Middle of a Revolution,'* BLOOMBERG (Nov. 23, 2016), https://www.bloomberg.com/features/2016-jack-bogle-interview [https://perma.cc/GX9R-GR89].

262. *See, e.g.*, Stephen J. Choi & Kevin E. Davis, *Foreign Affairs and Enforcement of the Foreign Corrupt Practices Act*, 11 J. EMPIRICAL LEGAL STUD. 409, 409–11 (2014) (examining the extent to which four broad theories (legality, altruism, self-interest, and coordination) explain the recent pattern of FCPA enforcement and showing that enforcement is affected not only by "legality," but also by other considerations).

considerations of the DOJ (or any other regulator) regarding corporate enforcement may be "unobserved from the outside,"[263] i.e., would not be reflected in the DOJ's press releases, and would not be apparent from the text of its formal policy.[264]

Traditionally, the privileged position and access of certain constituencies to lawmaking and regulatory power has been perceived as a negative phenomenon that can distort public policy.[265] Today, however, policymakers actually encourage institutional investors' engagement in public policymaking.[266] This Section explains how institutions' unique position in the capital markets has the potential to enhance corporate governance regarding macro legal risks. I begin with a short overview of institutional investors' power and then continue with an explanation of how this power can enhance corporate governance in companies in which institutional investors invest.

The rise in common ownership is a natural result of the increase in institutional stock ownership.[267] Recall that over the last three decades, U.S. capital markets have undergone a dramatic change and institutional investors—including pension funds, investment companies, mutual funds,

263. Garrett, *supra* note 54, at 1818.

264. *Id.* at 1814–38 (illustrating that point with regard to the contexts of tax evasion, antitrust, environmental crimes, FCPA, money laundering, and more).

265. *See, e.g.*, Randall Morck et al., *Corporate Governance, Economic Entrenchment, and Growth*, 43 J. ECON. LITERATURE 655, 660–62, 695–99 (2005) (explaining that in many countries, "controlling shareholders are generally wealthy families . . . [and] 30 percent of large firms are family-controlled in the average country," and as such enjoy significant political influence on politicians since such "families are likely to be effective political lobbyers, especially when they control large pyramidal groups of companies").

266. *See, e.g.*, RORY SULLIVAN ET AL., PRINCIPLES FOR RESPONSIBLE INV. & UNITED NATIONS ENV'T PROGRAMME, POLICY FRAMEWORKS FOR LONG-TERM RESPONSIBLE INVESTMENT: THE CASE FOR INVESTOR ENGAGEMENT IN PUBLIC POLICY 22 (2014), *available at* https://www.unpri.org/download?ac=1420 [https://perma.cc/9YU4-2ZJ3] ("It is crucial for policy makers and investors to work together." (quoting David Pitt-Watson, Co-Chair, UNEP Finance Initiative)). Similarly, as Luis A. Aguilar, who served as SEC Commissioner from 2008 to 2015 put it, "Too often, public company management and other issuers—represented by their lawyers, investment bankers, and industry groups—dominate the regulatory discussion. Institutional investors need to exercise their collective influence to improve the ongoing dialogue. We need to hear their views . . . ." *See* Luis A. Aguilar, Comm'r, SEC, Institutional Investors: Power and Responsibility, Speech at Georgia State University J. Mack Robinson College of Business (Apr. 19, 2013), *available at* https://www.sec.gov/news/speech/2013-spch041913laahtm [https://perma.cc/DA7Z-KSKY].

267. In fact, scholars are now focusing on institutions' index investing as the main catalyst for the rise in common ownership. *See, e.g.*, Gilje et al., *supra* note 4, at 1. However, even those who see index investing as the main reason take the growth in institutional ownership as another potential reason for the rise in common ownership. *Id.* at 21; *see also* JAMES MANCINI & ANITA NYESO, ORG. FOR ECON. CO-OPERATION & DEV., COMMON OWNERSHIP BY INSTITUTIONAL INVESTORS AND ITS IMPACT ON COMPETITION 10 (Nov. 29, 2017), *available at* https://one.oecd.org/document/DAF/COMP(2017)10/en/pdf [https://perma.cc/8VA8-V28K] ("[I]n the past decades there has been a rapid growth in the amount of capital that [institutional investors] invest on behalf of their clients. Several studies show that in some concentrated industries, there has been a corresponding increase in the extent of common ownership.").

insurance companies, hedge funds, banks, foundations and endowments —have greatly increased their ownership share of public companies and, in fact, have become the dominant owners of public companies in the United States,[268] as well as in most OECD countries.[269]

To illustrate, in 2016, mutual funds, pension funds, and insurance companies held shares worth $9.1 trillion, $2.3 trillion, and $811 billion of U.S. corporation shares, respectively; large private asset management firms, such as BlackRock, Vanguard, and Fidelity, manage assets worth $6.3 trillion, $5.1 trillion, and $2.1 trillion, respectively.[270] BlackRock alone engages with about "1,500 companies per year on a range of issues,"[271] and votes every year "at more than 15,000 shareholder meetings," on over "130,000 proposals."[272] As Goshen and Hannes illustrate, "the three biggest asset management institutions, BlackRock, Vanguard, and State Street, . . . are the 'single' largest shareholder, with mean ownership over 17%, in many U.S. listed companies (1662 out of approximately 3900 firms in 2015), and particularly among the S&P 500 (438 out of 500 firms)."[273]

Given their enormous power, institutional investors enjoy special access to policymaking, and decisionmakers cannot and do not want to ignore their opinions and wishes. Institutional investors provide institutional knowledge and insight that can inform the policies made by decisionmakers. They are invited to discussions and have relationships with influential decision makers. Institutional investors comment on regulatory initiatives at pre-proposal stage, when regulators are evaluating the need for future rulemaking by soliciting comments on concept releases,[274] and constitute a significant majority of the

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268. Elhauge, *supra* note 1, at 1283–93.

269. Çelik & Isaksson, *supra* note 23, at 94.

270. Zohar Goshen & Sharon Hannes, *The Death of Corporate Law*, 94 N.Y.U. L. REV. 263, 305–06 (2019).

271. *BlackRock 2015 Annual Report*, BLACKROCK (Mar. 2016), https://ir.blackrock.com/Interactive/newlookandfeel/4048287/annual/BlackRock2015AnnualReport/index.html [https://perma.cc/TD6M-VZKW].

272. *Id.*

273. Goshen & Hannes, *supra* note 270, at 307; *see also* Jan Fichtner et al., *Hidden Power of the Big Three? Passive Index Funds, Re-Concentration of Corporate Ownership, and New Financial Risk*, 19 BUS. & POL. 298, 313 (2017).

274. *See, e.g.*, Letter from Abe M. Friedman, Managing Dir., BlackRock, to Elizabeth M. Murphy, Sec'y, SEC (Oct. 29, 2010), *available at* https://www.sec.gov/comments/s7-14-10/s71410-254.pdf [https://perma.cc/R5N8-6H5K] (presenting BlackRock Executive's stance on the SEC's proposed concept release on U.S. proxy system); Letter from Scott C. Goebel, Senior Vice President & Gen. Counsel, Fidelity Invs., to Elizabeth M. Murphy, Sec'y, SEC (Oct. 20, 2010), *available at* https://www.sec.gov/comments/s7-14-10/s71410-194.pdf [https://perma.cc/Y6HU-S3B4] (presenting Fidelity Executive's stance on the SEC's proposed concept release on U.S. proxy system); Letter from Anne T. Chapman and Chad L. Norton, Vice Presidents of the Fund Bus. Mgmt. Grp., Capital Research & Mgmt. Co., to Elizabeth M. Murphy, Sec'y, SEC (Oct. 25, 2010), *available at* https://www.sec.gov/comments/s7-14-10/s71410-233.pdf [https://perma.cc/AN4X-PC5D] (presenting Capital Research and Management Company Executive's stance on the SEC's proposed concept release on U.S. proxy system).

commentators during the official comment period of important rulemakings.[275] Beyond these normal channels of policy influencing, however, institutions participate heavily in relevant roundtables conducted by the regulatory authorities and in congressional hearings, and their managing directors frequently testify before Congress.[276]

In fact, large institutional investors employ senior executives for government relations and public policy;[277] and hire senior directors for maintaining and improving the strong relationships they share with lawmakers and regulators. These directors continually interact with regulators and are able to provide institutions with policy guidance on a wide range of issues. Some of them are former senior officials in regulatory authorities and enjoy strong connections and knowledge with regulatory policy and practices.[278]

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275. *See, e.g.*, Mark J. Roe, *The Corporate Shareholder's Vote and Its Political Economy, in Delaware and in Washington*, 2 HARV. BUS. L. REV. 1, 33–34 (2012) (showing that a significant majority of comments regarding the SEC's 2003 shareholder access proposals were from institutional investors).

276. *See, e.g.*, BLACKROCK, 21ST CENTURY ENGAGEMENT, *supra* note 192, at 32 (explaining that common types of engagement on public policy includes "[r]ule-making petitions[; c]omment letters to the SEC and other regulatory [authorities; and l]etters to, meeting with[,] or testifying before the Congress").

277. *See, e.g.*, BLACKROCK, 2017 PROXY STATEMENT: NOTICE OF ANNUAL MEETING 82 (2017), *available at* https://ir.blackrock.com/Interactive/newlookandfeel/4048287/annual/BlackRock2016AnnualReport/pdf/BlackRock_Proxy_Statement_2017.pdf [https://perma.cc/SG3U-QM2D] ("BlackRock's Government Relations and Public Policy team coordinates the Company's engagement with policy makers and advocacy on public policy issues."); *Public Policy Engagement and Political Activities Policies*, BLACKROCK, https://www.blackrock.com/corporate/insights/public-policy/public-policy-engagement-and-political-activities-policies [https://perma.cc/E69U-NU8T] ("Our engagement with policy makers and advocacy on public policy issues is coordinated by our Global Public Policy Group. Members of the Global Public Policy Group work closely with BlackRock's business and legal teams to identify legislative and regulatory priorities, both regionally and globally, that will protect investors, increase shareholder value and facilitate responsible economic growth.").

278. For example, in December 2017, Sarah D. Green joined Vanguard as Chief Financial Crimes Officer. *See Sarah D. Green*, SIFMA, https://www.sifma.org/people/sarah-d-green [https://perma.cc/EAL2-MGZV]. Before joining Vanguard, Ms. Green served as Senior Director for Anti-Money Laundering Compliance at FINRA. *Id.* Previously, she worked at the SEC, specializing in Bank Secrecy Act and anti-money laundering issues. *Id.* Similarly, in 2017, former British Chancellor George Osborne joined BlackRock and was paid £650,000 a year for working four days a month in his senior adviser role. *See, e.g.*, Rowena Mason, *George Osborne to Be Paid £650,000 for Working One Day a Week*, GUARDIAN (Mar. 8, 2017, 1:34 PM), https://www.theguardian.com/politics/2017/mar/08/george-osborne-to-be-paid-650000-for-working-one-day-a-week-blackrock-salary [https://perma.cc/GB4M-LGSM]. Other ex-Treasury officials who joined BlackRock are Antony Manchester, who served as head of the Treasury's EU Financial Services Unit between 2009 and 2010 and "joined BlackRock in 2017 to to [sic] lead the firm's Brexit position," and Rupert Harrison, who served from 2006 to 2015 as the Chief of Staff to the then Chancellor Osborne. *See* Jack Gilbert, *Revealed: BlackRock's 14 Treasury Meetings*, CITYWIRE: NEW MODEL ADVISER (Jan. 11, 2018), https://citywire.co.uk/new-model-adviser/news/revealed-blackrocks-14-treasury-meetings/a1082574 [perma.cc/B92G-T7R7].

The dynamic described above allows institutional investors to inform management teams of companies in which they invest about developments in law and regulation.[279] Moreover, institutional investors maintain cooperation among themselves through networks. One example is the global network ICGN (International Corporate Governance Network), an investor-led organization, representing mainly institutional investors (across 50 countries) that represent funds under management in excess of U.S. $26 trillion; the ICGN aims to promote effective standards of corporate governance and investor stewardship, with members such as BlackRock, Capital Group, and Fidelity International.[280] Leaders of this organization have direct access to policymakers.[281]

Lastly, large institutional investors interact with policymakers through "off the record" conversations. As Norm Champ, a former director of the Division of Investment Management at the SEC explained, the SEC's Division of Investment Management has established a "robust and ongoing dialogue with the leadership of larger asset management firms."[282] Such a dialogue, by its very nature, occurs behind the scenes where "senior managements of significant asset management firms" enjoy special access to the SEC's senior management.[283]

Appendix A to this Article contains a table that summarizes interactions of some of the largest institutional investors with the SEC's Chairmen in recent years. This table, although based on partial information published on the SEC's official website, shows how since 2009, high level decision makers at top institutional investors have met frequently with the SEC Chairman, both in person and by phone.[284] Senior executives at BlackRock have met 15 separate times during this time span with the SEC chairman.[285] Delegations from BlackRock have included senior executives such as Chairman and CEO Larry Fink, and Vice Chairman of the Global Executive Committee, Barbara Novick, among others. Similarly, at Fidelity, senior executives have met with

279. *See, e.g.*, BAUER & VIEHS, *supra* note 20, at 4–6; Mallow & Sethi, *supra* note 20, at 389–91.

280. *Our Members*, INT'L CORP. GOVERNANCE NETWORK, https://www.icgn.org/members/our-members [https://perma.cc/G5X3-WPPK].

281. *See, e.g.*, Jane Croft, *Investors Warn on Bribery Act Dilution*, FIN. TIMES (Feb. 24, 2011), https://www.ft.com/content/d906fd20-3f86-11e0-a1ba-00144feabdc0 [https://perma.cc/5VA9-HAMN] (describing how Carl Rosen, the then-executive director of the ICGN, contacted Jeremy Heywood, who as Cabinet Secretary is the UK's most senior civil servant, regarding the anti-bribery act in the UK).

282. Champ, *supra* note 202. Champ encourages institutional investors to build a relationship with the regulator stating, "If your regulator knows who you are and what you are trying to do with regard to compliance, you may get the benefit of the doubt when something does go wrong. I am not saying that you will escape a serious violation of the rules but you may get a lighter punishment." *Id.*

283. *Id.*

284. *See infra* Appendix A.

285. *See infra* Appendix A.

the SEC Chairman 14 times over the past ten years.[286] These meetings have included people such as Fidelity Investments CEO Abby Johnson, and Senior Vice President and Head of Equity of Fidelity Capital Markets, John Donahue. State Street has had nine such meetings since 2009 and Vanguard has had 13, similarly with senior executives.[287] Finally, representatives of institutions may sometimes serve as members in subcommittees of enforcement authorities.[288]

Further, data compiled by the Center for Responsive Politics' OpenSecrets.org website, compiling its data based on figures from the Senate Office of Public Records, reveal that BlackRock spent over $2 million on lobbying for each year between 2011–2016 and $1.8 million for 2017;[289] while Vanguard spent $1.48 million in 2011, $1.94 million in 2012, and more than $2 million for each year between 2013 and 2017.[290]

To further focus the discussion above, it is useful to analyze a "ViewPoint" released by BlackRock in May 2011 describing the recent development regarding the Foreign Account Tax Compliance Act ("FATCA") and the challenges it poses to investors.[291] The ViewPoint describes "[h]ow . . . the IRS [will] administer the FATCA system and what . . . it [will] cost" and the "[p]otential [i]mpacts for [i]nvestors."[292] BlackRock notes that it supports the U.S. government's goal to ensure tax payments, and to that end, BlackRock is "actively engaged in dialogue directly with the IRS and Treasury and via trade associations in an attempt to assist in the development of rules that are fair and administrable without creating undue hardship, including confusion for our clients or disrupting the efficient functioning of the capital markets."[293]

The bottom line here is that the common ownership trend should be seen as part of a wider trend of the increasing power of institutional investors. Such power allows institutional investors comfortable access to policymaking

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286. *See infra* Appendix A.

287. *See generally Chairman's Calendar*, U.S. SEC. & EXCHANGE COMMISSION, https://www.sec.gov/foia/docs/sec-chair-calendar.htm [https://perma.cc/B6UL-UJ6T] (last modified May 31, 2018) (providing the calendars of the current and previous SEC Chairmen detailing who they met with and when).

288. For example, Ananth Madhaven, the Global Head of Research for ETF and Index Investing at Blackrock, serves as the Chair of the SEC's ETFs and Bond Funds Subcommittee. *See Fixed Income Market Structure Advisory Committee—Subcommittees*, U.S. SEC. & EXCHANGE COMMISSION, https://www.sec.gov/spotlight/fixed-income-advisory-committee/fixed-income-market-structure-advisory-committee-subcommittees.htm [https://perma.cc/4VNM-LJYW] (last modified Oct. 16, 2019).

289. *Annual Lobbying by BlackRock Inc.*, OPENSECRETS.ORG, https://www.opensecrets.org/lobby/clientsum.php?id=D000021872 [https://perma.cc/GE8V-5GVJ].

290. *Annual Lobbying by Vanguard Group*, OPENSECRETS.ORG, https://www.opensecrets.org/lobby/clientsum.php?id=D000022305 [https://perma.cc/STY2-BSXJ].

291. BLACKROCK, FOREIGN ACCOUNT TAX COMPLIANCE ACT: CHALLENGES FOR INVESTORS 1–2 (2011), *available at* https://www.blackrock.com/corporate/en-at/literature/whitepaper/viewpoint-foreign-account-tax-compliance-act-may-2011.pdf [https://perma.cc/PA66-FWBA].

292. *Id.* at 3.

293. *Id.* at 4.

and consequently improves their readiness to identify and respond to legal and regulatory developments in general, and macro legal risks in particular, while allowing policymakers access to information on industry wide concerns and problems.

C. Experimental Learning

As explained above, common ownership can improve the awareness of institutional investors regarding upcoming legal and regulatory changes due to the increased incentive to take part in discussions about policymaking. However, the full effects of law and regulation cannot be fully assessed before they come into effect, and therefore, a process of learning is required once the law or regulation in question *does* take effect. This point has long been recognized regarding policymaking in general. As explained by Yair Listokin, "[b]efore implementing a policy, policymakers may have only a dim idea about the effects of the policy."[294] Listokin continues, "[a]fter implementing the policy" and through a "learning" process, uncertainty is reduced and policymakers "have a much greater ability to predict the policy's impacts."[295] Put differently, when dealing with a new law, regulation, or trend in enforcement, "experimental learning" may be needed. As Daniel Farber emphasized regarding experimentalism and dynamic learning in the field of environmental policy: "Rather than viewing [environmental] policy making as a one-shot exercise, in which the goal is to adopt the optimum solution based on current information, we might do better to think of a continuous process of learning and experimentation."[296]

The FCPA illustrates this point well. Although the Act officially turns 40 this year, given that the U.S. government started to devote vast resources to deal with FCPA cases only from 2004 or 2005, some degree of ambiguity still surrounds elements of the Act.[297] This is because, at least in part, the Act "has been interpreted largely through settlements rather than through judicial review, with the result that very little guidance is available regarding what specific conduct is prohibited."[298] This is because the scope to which the FCPA

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294. Yair Listokin, *Learning Through Policy Variation*, 118 YALE L.J. 480, 483 n.1 (2008).

295. *Id.*

296. Daniel A. Farber, *Environmental Protection as a Learning Experience*, 27 LOY. L.A. L. REV. 791, 791 (1994); *see also* Michael Abramowicz et al., *Randomizing Law*, 159 U. PA. L. REV. 929, 931 (2011) ("Policymakers and commentators frequently refer loosely to new laws and legal institutions as 'experiments.'").

297. *See* Philip Urofsky et al., *How Should We Measure the Effectiveness of the Foreign Corrupt Practices Act? Don't Break What Isn't Broken—The Fallacies of Reform*, 73 OHIO ST. L.J. 1145, 1166–68 (2012) (explaining how the meaning of some elements of the FCPA have remained vague).

298. *Id.* at 1166; *see also Foreign Corrupt Practices Act: Hearing Before the H. Subcomm. on Crime, Terrorism, and Homeland Security*, 112th Cong. 1 (2011) ("Because the risks of prosecution are so great, with million-dollar fines and possible prison sentences, companies would rather settle with the Justice Department than go to court. The result is a shortage of court decisions determining the limits of the law. Companies must then analyze cases prosecuted by the Justice Department

may be extended depends on the agendas of enforcement authorities, mostly those of the DOJ and the SEC; agendas that may be changed from time to time.[299] To deal with the legal risks of the FCPA, companies should know all significant nuances, and experimental learning can contribute positively to this.

Common ownership may provide institutional investors with the requisite experimental learning. Recall, large institutional investors own shares in hundreds, sometimes thousands of companies. Many of those companies belong to the same industries. Due to this common ownership structure, institutional investors can actually create a *network* of companies operating within the same industry. Such a network may facilitate information flow and coordination among companies as well as cooperation among relevant functionaries, especially compliance officers. Institutions can use previous experience regarding certain companies in which they invest to enhance corporate governance in other companies in which they also own shares. Once one (or a few) companies have become "infected" by being subject to the DOJ's (or other authority's) investigation, institutional investors can quickly warn other companies about the suspected factors that are being investigated.

Returning to the FCPA example, institutional investors can learn a lot from the investigation of an infected company, even in the situation of a company-run internal investigation. They can learn about illegal techniques that the company uses, as well as corrupt agents, such as distributors and manufacturers with whom the company was doing business. Many times, these are the same agents that are doing business with other companies that operate within the same industry in which the infected company operates (i.e., those agents are often repeat players).[300] Institutional investors can use their knowledge to blacklist these corrupt agents.

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and the settlements reached to determine how to do business in foreign markets. The business community complains that the absence of case law interpreting the breadth and scope of the FCPA inflates the Department's prosecutorial discretion and confounds industries' ability to conform to the law.").

299. *See, e.g.*, Rob Tricchinelli, *SEC to Bring New Kinds of Cases on Financial Reporting, FCPA Violations*, BLOOMBERG (May 15, 2015), https://www.bna.com/sec-bring-new-n17179926571 [https://perma.cc/SH83-YXNW] (presenting SEC Enforcement Director Andrew Ceresney's statement that "[t]he Securities and Exchange Commission will bring new kinds of enforcement cases for financial reporting and Foreign Corrupt Practices Act violations in the coming months").

300. Some agents can be tracked and identified by both companies and large institutional investors as agents that companies should not deal with. *See, e.g.*, Complaint at 11, SEC v. Teva Pharm. Indus. Ltd., Case 1:16-cv-25298 (S.D. Fla. 2016) ("In 2011, Teva Russia hired a new executive, formerly employed at a large U.S. pharmaceutical company. After learning that Teva was conducting business with Russian Distributor, the new Teva Russia executive informed another Teva Russia executive that his former employer prohibited its employees from conducting business with Russian Distributor based on corruption concerns."); Deferred Prosecution Agreement, United States v. Zimmer Biomet Holdings, Inc., *supra* note 226, at 5

Such steps are likely to reduce the exposure of companies to significant macro legal risks that by their very nature are frequently industry-wide. For example, assume that BlackRock has a stake in firms A, B, C, and D. In 2008, the DOJ begins an investigation of firms A and B regarding corruption in Nigeria. Perhaps A and B even employed a certain corrupt agent. BlackRock is likely to become aware of the facts and learn about the illegal techniques and corrupt agents A and B used to disguise bribes and transfer money in Nigeria. Thus, BlackRock gains experience regarding the enforcement capabilities and techniques under the FCPA and can apply this learning and experience to preemptively help firms C and D. Perhaps before the investigation BlackRock wasn't completely sure of the application of the FCPA to this particular type of corruption or specifically how the enforcement proceeding would play out, but after dealing with it in the case of A and B, they can apply their learning to other companies moving forward who deal with the same risks.

Finally, it is interesting to note that enforcement authorities share relevant information among themselves about illegal practices. As Assistant Attorney General Leslie R. Caldwell put it, "Increasingly, we and our counterparts share information about bribery schemes. We report schemes to one another. And, where appropriate, we discuss strategy and coordinate our use of investigative techniques, so that we can obtain the best possible results, especially in very high-impact cases."[301] In the same vein, institutional investors can use their special position as common owner to enhance information flow among companies in which they invest.[302]

("Biomet knew that Brazilian Distributor previously had paid bribes to win business for Biomet through Brazilian Distributor Company A, and as a result, Biomet had prohibited its employees from using all companies affiliated with Brazilian Distributor. Despite knowing this, Biomet . . . allowed Brazilian Distributor to sell, import, and market its products through Brazilian Distributor Company B . . . .").

301. Leslie R. Caldwell, Assistant Att'y Gen., Dep't of Justice, Assistant Attorney General Leslie R. Caldwell Speaks at American Conference Institute's 31st International Conference on the Foreign Corrupt Practices Act (Nov. 19, 2014), *available at* https://www.justice.gov/opa/speech/assistant-attorney-general-leslie-r-caldwell-speaks-american-conference-institute-s-31st [https://perma.cc/EH8A-CM66]; *see also* Robert Khuzami, Dir., Div of Enf't, SEC, Testimony Concerning Investigating and Prosecuting Fraud After the Fraud Enforcement and Recovery Act Before the United States Senate Committee on the Judiciary 25 (Sept. 22, 2010), *available at* https://www.judiciary.senate.gov/imo/media/doc/10-09-22KhuzamiTestimony.pdf [https://perma.cc/MK6E-45CC] ("[T]he FCPA Unit recently conducted a multi-day FCPA training 'boot camp' for our law enforcement colleagues, including DOJ and the FBI, to assimilate knowledge and identify best practices for investigations that often span the globe.").

302. Relatedly, institutional investors can also collaborate and share information among themselves as to common risks, through membership in various governance networks. For example, BlackRock, Vanguard, and Fidelity are signatories to the United Nations Principles for Responsible Investment ("UNPRI"), a voluntary framework for incorporating ESG (environmental, social, and governance) issues into investment decision-making and ownership practices. *Signatory Directory*, PRINCIPLES FOR RESPONSIBLE INV., https://www.unpri.org/signatories/signatory-directory [https://perma.cc/6QMD-XFWT].

VI. POTENTIAL OBJECTIONS—BOARD INTERLOCKS AND PROFESSIONAL ADVICE

In discussing the idea of common ownership as a structure that may promote more active corporate governance and compliance, one might ask, why, when dealing with macro legal risks that require monitoring functions, directors are not more effective monitors than institutional investors? This question may be especially relevant given that today's directors often serve on multiple corporate boards. Before answering this question, it should be noted that common ownership advantages are not meant to replace potential advantages of board interlocks (directors serving on multiple boards). Instead, they may be complementary mechanisms. In many ways, however, the advantages of common ownership are superior to the advantages of board interlocks.

First, most busy directors can sit on a limited number of Boards, maybe three or four, often not even in the same industry. This relatively low level of interlocking Boards is not likely to reach the potential advantages of common ownership as discussed above. Over the last few years, a majority of directors have faced restrictions on board interlocking, due to the commonly held belief that directors have become too busy and do not have sufficient time to devote to board responsibilities. As the 2016 Spencer Stuart Board Index shows, 74 percent of S&P 500 boards "have established some limit on their directors' ability to accept other corporate directorships."[303] The report elaborates, "61% of boards set a numerical limit for other board service applying to all directors; of those, 5% cap additional directorships at two, 36% at three, 40% at four, and 19% at five or six. No company limits other directorships to one."[304] Such limitations may make it difficult for directors to create a network that would provide the benefits inherent in the common ownership structure.

Second, directors' independence is a very important condition when dealing with monitoring functions.[305] However, it is common knowledge that directors' independence is limited. This is due to their social relationships with managers and the corporation itself,[306] as well as their interactions with

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303. SPENCER STUART, 2016 SPENCER STUART BOARD INDEX 15 (2016), *available at* https://www.spencerstuart.com/~/media/pdf%20files/research%20and%20insight%20pdfs/spencer-stuart-us-board-index-2016.pdf [https://perma.cc/TGY6-3NPC].

304. *Id.*

305. Lucian A. Bebchuk & Assaf Hamdani, *Independent Directors and Controlling Shareholders*, 165 U. PA. L. REV. 1271, 1280–84 (2017) (illustrating the increasing reliance on independent directors in the United States and around the world). *See generally* Jeffrey N. Gordon, *The Rise of Independent Directors in the United States, 1950–2005: Of Shareholder Value and Stock Market Prices*, 59 STAN. L. REV. 1465 (2007) (reporting that the percentage of independent directors on the boards of large public companies has risen from 20 percent in 1950 to 75 percent in 2005).

306. Lisa M. Fairfax, *The Uneasy Case for the Inside Director*, 96 IOWA L. REV. 127, 146–52 (2010).

one another, i.e., their "natural collegiality" while serving on the Board.[307] These factors may undermine their monitoring role. Even the ability of independent directors to monitor management teams may be limited, because fulfilling this role depends on having relevant information supplied by management.[308] Finally, directors play a dual role, serving to both monitor and advise management in order to design the strategy and the policy of the company, and thus guide the management and the employees. There is a potential conflict between these roles: with more time-consuming advising may come lower monitoring quality.[309] Taken together, directors, even those who sit on multiple boards, may be less capable in dealing with macro legal risks than large institutional investors.

To complete the picture, another argument is that the advantages of common ownership can be achieved by professionals, such as lawyers and auditors who can share the knowledge of certain practices with firms that employ them and thus create an intercorporate network. The network that can be created by professionals has been mentioned in a general manner by the literature.[310] While I acknowledge that professionals are likely to play an important role in contributing to the spread of knowledge regarding macro legal risks, much like with directors serving on multiple boards, professionals are better suited to play a complimentary role in monitoring than the main role. Professionals' capacity to advise companies does not necessarily translate into a strong ability to monitor them and enhance their compliance with macro legal risks. Recall, institutional investors have a real power to affect companies' policy and actions. They can use their voting power to oppose reelection of certain directors who they deem responsible for the failure to oversee management and employees;[311] it may even be that the mere threat of not being reelected by institutional investors could be sufficient to induce

307. *Id.* at 152; *see also* Claire A. Hill & Brett H. McDonnell, *Disney, Good Faith, and Structural Bias*, 32 J. CORP. L. 833, 863 (2007) (discussing the structural bias caused by the relationships between directors and officers). *See generally* Marleen A. O'Connor, *The Enron Board: The Perils of Groupthink*, 71 U. CIN. L. REV. 1233 (2003) (discussing the Enron Board's role in the scandal and concentrates on the groupthink bias as a reason for the scandal).

308. Fairfax, *supra* note 306, at 161.

309. *See generally* Renée B. Adams & Daniel Ferreira, *A Theory of Friendly Boards*, 62 J. FIN. 217 (2007) (discussing implications of dual roles in board and management positions); Milton Harris & Artur Raviv, *A Theory of Board Control and Size*, 21 REV. FIN. STUD. 1797 (2008) ("[T]ak[ing] account of both the direct effects of agency problems on corporate decision-making and the indirect effects of agency problems on communication between insiders and outsiders."); Dong Chen, The Monitoring and Advisory Functions of Corporate Boards: Theory and Evidence (Feb. 3, 2008) (unpublished manuscript), *available at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1251846 [https://perma.cc/3U8K-J6JT] (showing that higher advising intensity of directors is associated with lower monitoring quality and higher agency costs).

310. *See* Michael Barzuza & Quinn Curtis, *Board Interlocks and Corporate Governance*, 39 DEL. J. CORP. L. 669, 695 (2015); John Bizjak et al., *Option Backdating and Board Interlocks*, 22 REV. FIN. STUD. 4821, 4827 (2009).

311. *See* Mallow & Sethi, *supra* note 20, at 392–94.

directors and managers to enhance compliance.[312] Professionals do not have such an effective position. In fact, professionals may become overly deferential and accommodating to their clients—companies to which they give advice—and because they may become afraid of losing their clients, they may not be able to exert the necessary influence on companies' directors and managers and may not be able to convince them to adopt better governance mechanisms that would minimize exposure to macro legal risks.[313] Because of this, institutional investors are better positioned to monitor companies than directors and professionals.

VII. IMPLICATIONS

The theory of the virtue of common ownership in corporate compliance that has been discussed so far in this Article has two major implications. First, it contributes to the common ownership debate, and argues that regulatory changes that have recently been proposed to deal with antitrust concerns related to common ownership should take into account the virtue of common ownership in corporate compliance. This is especially true given the antitrust concerns that have expanded beyond the academic arena. As has recently been acknowledged, the common ownership debate has broken out of the academic sphere as academic works have succeeded in driving major policymakers to consider a needed regulatory response. In fact, common ownership has been discussed in the recent Federal Trade Commission Hearing on Competition and Consumer Protection,[314] and in OECD discussions,[315] as well as in other contexts.

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312. The notion of a threat of activism as a catalyst for better corporate governance has been discussed in the context of hedge fund activism. *See, e.g.*, Frank Partnoy & Randall Thomas, *Gap Filling, Hedge Funds, and Financial Innovation*, *in* NEW FINANCIAL INSTRUMENTS AND INSTITUTIONS: OPPORTUNITIES AND POLICY CHALLENGES 136 (Yasuyuki Fuchita & Robert E. Litan eds., 2007) ("[J]ust the potential threat of hedge fund activism may stimulate corporate managers to engage in change-of-control transactions to maximize value before they become targets."); Dionysia Katelouzou, *Myths and Realities of Hedge Fund Activism: Some Empirical Evidence*, 7 VA. L. & BUS. REV. 459, 497 (2013) ("Perhaps the most drastic strategy an activist hedge fund can employ in the course of an activist campaign is to threaten to launch—or actually launch—a takeover bid.").

313. For a discussion of this possibility, see generally Theodore Eisenberg & Jonathan R. Macey, *Was Arthur Andersen Different? An Empirical Examination of Major Accounting Firm Audits of Large Clients*, 1 J. EMPIRICAL LEGAL STUD. 263 (2004) (discussing the danger of capture of auditors by their clients); and Hugh P. Gunz & Sally P. Gunz, *Client Capture and the Professional Service Firm*, 45 AM. BUS. L.J. 685 (2008) (recognizing how clients can exert considerable influence over professionals who advise them).

314. Robert J. Jackson, Jr., *Common Ownership: The Investor Protection Challenge of the 21st Century*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Dec. 14, 2018), https://corpgov.law.harvard.edu/2018/12/14/common-ownership-the-investor-protection-challenge-of-the-21st-century [https://perma.cc/YU82-2KXP] ("Today's hearing is a victory for those who believe that researchers have a responsibility to pursue policy impact in their work.").

315. *Common Ownership by Institutional Investors and Its Impact on Competition*, OECD (Dec. 6, 2017), http://www.oecd.org/competition/common-ownership-and-its-impact-on-competition.htm [https://perma.cc/YZK5-5CW9].

Until now, the common ownership debate has been focused on the question of whether the common ownership phenomenon has a negative impact on competition, and if so, what is the channel through which institutional investors convince firms in which they invest to discourage competition. Little attention, if any, has been given to the potential virtues of common ownership in corporate law. This Article suggests that policy makers should consider the virtues discussed in this Article when considering whether or not to police common ownership levels.

Second, this Article contributes to the literature discussing the agency problems of institutional investors and tries to provide a more complete picture regarding investors' incentives and involvement. This literature has traditionally perceived institutional investors as passive stewards when it comes to the corporate governance landscape. This is mainly because of two reasons: (1) managers of institutional investors charge fees that are calculated as a flat percentage of assets under management and do not charge performance-based fees[316] and (2) corporate governance activities, e.g., voting on director elections, executive compensation, and other issues, are very costly. The latter is also based on various traditional conceptions: (a) governance activities require firm-specific / transaction-driven analysis, (b) corporate issues are controversial and do not enjoy a consensus, and thus cannot be dealt by generic, one-size-fits-all models, and (c) governance initiatives are likely to attract managers' opposition and thus impose costs on institutional investors.[317]

The reasons noted above have led scholars to view the potential for institutional investors involvement in corporate governance skeptically. In recent years, this skepticism has been raised especially regarding index funds that by their very nature track the index's performance. These funds, the argument goes, cannot be expected to invest in corporate governance. According to some commentators, these funds lack *any* incentive to invest in corporate governance.[318] One scholar has even asked lawmakers to restrict passive institutional investors from voting at shareholder meetings.[319] This literature has perceived corporate governance in a *monotonous* way and take the need to tailor governance activities to the specific characteristics of firms, as given. This Article questions this perception and demonstrates it is not necessarily the case, especially regarding corporate compliance—in which institutional investors, even those that are considered "passive investors," have the potential to play a vital role in corporate law.

316. *See, e.g.*, Bebchuk et al., *supra* note 167, at 97; Kahan & Rock, *supra* note 24, at 1057–58.

317. *See supra* Part IV and Section V.A.

318. Bebchuk & Hirst, *supra* note 204, at 19–29; Lund, *supra* note 191, at 495 ("[P]assive funds lack a financial incentive to ensure that each of the companies in their portfolios are well-run.").

319. Lund, *supra* note 191, at 525.

VIII. CONCLUSION

Over the last few years, rates of common ownership have increased dramatically. This phenomenon has spurred an intense debate and become the subject of massive media and scholarship attacks, warning of common ownership's negative effects. According to these concerns, the increase in common ownership is linked to an increase in institutions' market power, and more generally, to market concentration, less competition and the ensuing adverse effects on the economy. Accordingly, there have been calls to adopt legal or regulatory reforms limiting common ownership levels. While the common ownership debate shows no signs of waning, little attention, if any, has been given to the potential of common ownership to promote enhanced corporate governance, and more specifically, to improve the ability and incentives of institutional investors to monitor their portfolio companies.

This Article attempts to fill that void by demonstrating how common ownership has the potential to enhance institutional investor's incentives to improve their awareness of macro legal risks—risks of criminal investigations and criminal and civil proceedings that are common to entire industries such as healthcare (pharmaceuticals), finance and energy—and to respond appropriately. It also demonstrates how common ownership is likely to improve the ability of institutional investors to recognize new trends and patterns by having privileged access to rulemaking and by creating a network of companies that have similar legal exposure and that allow experimental learning. This Article considers the potential virtue of common ownership in corporate law and compliance.

APPENDIX A

Table 2. Meetings Between Large Institutional Investors and SEC Chairmen[320]

Chairman	BlackRock	Fidelity	State Street	Vanguard
Chairman Jay Clayton, serving from May 2017 – present.	Nov. 27, 2017 – Meeting with Larry Fink, Chairman & CEO of BlackRock. Oct. 22, 2017 – Phone call with Mark Wiseman, Global Head of Active Equities at BlackRock. June 28, 2017 – Meeting with Barbara Novick, Vice Chairman of the Global Executive Committee at BlackRock.	July 6, 2017 – Meeting with Abby Johnson, CEO of Fidelity Investments.	July 19, 2017 – Meeting with Francis Koudelka, Senior VP Global Services Business, State Street, and others.	Dec. 6, 2017 – Meeting with Vanguard Investment Management, including: Tim Buckley, President; Anne Robinson, General Counsel; and Jerry Golden, Head of Government Relations. June 20, 2017 – Phone call with Bill McNabb, CEO of Vanguard.
Michael S. Piwowar, SEC's acting Chairman between January 2017 and May 2017.	Mar. 13, 2017 – Meeting with Barbara Novick, Vice Chairman at BlackRock and Kate Fulton, Managing Director at BlackRock.	Apr. 19, 2017 – Meeting with Abby Johnson, Chairman & CEO of Fidelity and with Fidelity leadership, legal representatives, public affairs and policy group.	Apr. 6, 2017 – Meeting with Jim Ross, Executive VP, and Steve Patterson, VP, of State Street Corporation.	Mar. 7, 2017 – Meeting with Mike Buek, Principal & Portfolio Manager at Vanguard, and others.
Chair Mary Jo White, served between April 2013 and January 2017.	Feb. 4, 2016 – Meeting with BlackRock: Larry Fink, Chairman &	Oct. 12, 2016 – Meeting with Abigail Johnson, President & CEO, and James	Apr. 28, 2015 – Meeting with members of the Boston Asset Manager	Aug. 3, 2016 – Meeting with Vanguard: Tim Buckley, Chief Investment

320. Data drawn from the *Chairman's Calendar*, *supra* note 287.

Chairman	BlackRock	Fidelity	State Street	Vanguard
	CEO, and Barbara Novick, Vice Chairman. Nov. 5, 2015 – Meeting with Laurence Fink, Chairman & CEO, and Kathryn Fulton, Managing Director of BlackRock. Jan. 8, 2015 – Meeting with Barbara Novick, Vice Chairman, and Kathryn Fulton, Managing Director of BlackRock. May 20, 2014 – Meeting with BlackRock: Larry Fink, CEO; Barbara Novick, Vice Chairman; and Kathryn Fulton, Managing Director. Jan. 26, 2014 – Meeting with the Corporate Directors Forum, including Michelle Edkins, Global Head,	Johnson, EVP Government Relations of Fidelity. June 2, 2016 – Meeting with Securities Industry and Financial Markets Association ("SIFMA"): John Donahue, Senior VP and Head of Equity, Fidelity Capital Markets, and others. Apr. 28, 2015 – Meeting with members of the Boston Asset Manager Association, including Jonathan Chiel, Executive VP & General Counsel, Fidelity Investments, and James Febeo, Senior VP & Head of Regulatory Affairs, Fidelity Investments. Apr. 22, 2015 – Meeting with SIFMA Board of Directors, including Gerard McGraw, President, Fidelity Institutional,	Association, including Ron O'Hanley, President & CEO, State Street Global Advisors; Joseph Barry, Senior VP for Regulatory Industry, State Street Global Advisors. Apr. 9, 2014 – Meeting with the Financial Services Forum, including Joseph Hooley, Chairman, President, & CEO, State Street Corp.	Officer; John Hollyer, Principal & Head of Risk Management Group; Jerry Golden, Principal & Head of Washington Office; and Tara Buckley, Senior Counsel & Head of Investment Management Regulations Group. Feb. 23, 2016 – Meeting with William McNabb, Chairman & CEO of Vanguard, and others. Jan. 14, 2016 – Meeting with Vanguard: Michael Buek, Head of Equity Trading; Joel Dickson, Head of Product Development & ETF Expert; John Bisordi, Senior Counsel on Market Structure; Brian McCarthy, Retail Investor Trading; Thomas Bartolacci, Head of ETF Capital Markets; Gerry O'Reilly, Indexed Equity

Chairman	BlackRock	Fidelity	State Street	Vanguard
	Corporation Government and Investment, BlackRock. Jan. 7, 2014 – Meeting with the Financial Services Roundtable, including Kathryn Fulton, Managing Director, BlackRock. Nov. 26, 2013 – Meeting with Barbara Novick, Vice Chairman, BlackRock. July 30, 2013 – Meeting with Treasury Borrowing Advisory Committee (including Stuart Spodek, Managing Director, Multi-Sector and Mortgages. Group, BlackRock). July 11, 2013 – Meeting with BlackRock: Barbara Novick, Vice Chairman, and Matthew J.	Fidelity Investments. Sept. 3, 2013 – Meeting with Fidelity Investments: Jonathan Chiel, General Counsel; Abby Johnson, President, Fidelity's Financial Services; and J.J. Johnson, Director, Fidelity's Government Affairs Office. July 18, 2013 – Meeting with National Society of Compliance Professionals, including Charles Senatore, Head of Corporate Compliance at Fidelity Investments.		Portfolio; and Jillien Flores, Government Relations. Aug. 6, 2013 – Meeting with Bill McNabb, Chairman, Vanguard.

Chairman	BlackRock	Fidelity	State Street	Vanguard
	Mallow, Senior Managing Director.			
Chairman Mary L. Schapiro, served between January 2009 and August 2012.	May 8, 2012 – Meeting with Vanguard, Blackrock, and others: Barbara Novick and Rich Hoerner, Blackrock. Feb. 16, 2012 – Meeting with BlackRock: Larry Fink, CEO; Kate Fulton; and Barbara Novick.	June 5, 2012 – Meeting with Abigail P. Johnson, President, Fidelity Personal, Workplace and Institutional Services, and Scott C. Goebel, Senior VP and General Counsel, Fidelity Management and Research Company; Ronald P. O'Hanley, President, Asset Management & Corp. Services. Mar. 14, 2012 – Meeting with Fidelity Investments: Ronald O'Hanley, President; Scott Goebel, Senior VP & General Counsel; Charles Morrison, President of Fixed-Income Group; Nancy Prior, President of the Money Market Group. Oct. 6, 2010 – Speak to members of the Financial Services Forum, including Abigail Johnson,	Oct. 6, 2010 – Speak to members of the Financial Services Forum, including: Joseph Hooley, President & CEO, State Street Corporation. Oct. 1, 2010 – Meeting with the Board of Directors of the Financial Services Roundtable, including: Stefan Gavell, Executive VP, State Street Corporation. Sept. 28, 2010 – Meeting with the Board of Directors of the Managed Funds Association, including: Jack Klinck, Executive Vice President, Global Head, Corporate Development & Global Relationship Management, State Street Corporation.	May 8, 2012 – Meeting with Vanguard, Blackrock, and others: Bill McNabb and Laura Merianos, Vanguard. Feb. 3, 2012 – Meeting with Investment Company Institute: George Upham Sauter, Chief Investment Officer & Managing Director, Vanguard Group, and others. July 26, 2010 – Meeting with Jack Brennan, Chairman, The Vanguard Group, Inc. and Chairman, Financial Accounting Foundation, and others. June 23, 2010 – Meeting with Jack Brennan, The Vanguard Group, Inc., and others.

Chairman	BlackRock	Fidelity	State Street	Vanguard
		President, PWI, Fidelity Investments. Oct. 1, 2010 – Meeting with the Board of Directors of the Financial Services Roundtable, including Ronald O'Hanley, Fidelity Investments. Apr. 28, 2010 – Meeting with the Investment Company Institute, including: Kevin Meagher, VP, Associate General Counsel, Fidelity Management & Research Co.; Alex Marx, Head Trader, Bonds, Fidelity Management & Research Co. Apr. 6, 2010 – Speak to members of the Financial Services Forum, including Edward Johnson, Fidelity Investments.	Apr. 6, 2010 – Speak to members of the Financial Services Forum, including: Joseph Hooley, State Street Corporation.	Apr. 28, 2010 – Meeting with the Investment Company Institute, including: John Hollyer, Principal, Risk Management & Strategy Analysis, The Vanguard Group; Natalie Bej, Principal, Securities Regulation, Legal Department, The Vanguard Group. Mar. 17, 2010 – Phone call with Jack Brennan, Chairman, The Vanguard Group, Inc. and Chairman, Financial Accounting Foundation.