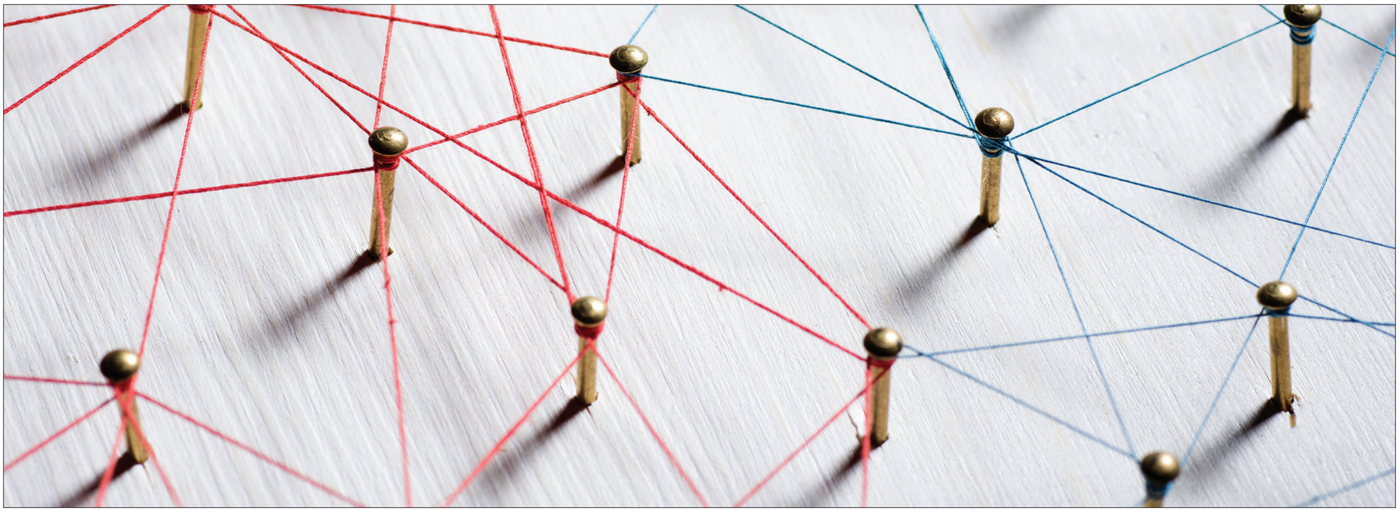

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Interlocking Directorates

The antitrust enforcement agencies closely monitor companies that share common board members and may take enforcement action where appropriate. Companies and their counsel should understand the risks associated with having interlocking directorates and how to avoid potential liability.

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Interlocking directorates (also known as interlocks) occur where a person serves as an officer or a director of two corporations. While they generally are legal, interlocking directorates between competing corporations are prohibited under the US antitrust laws, due to their potential to result in anticompetitive effects, such as allowing competitors to coordinate business decisions and exchange competitively sensitive information. The principal statute that prohibits interlocking directorates is Section 8 of the Clayton Act (15 U.S.C. § 19).

Potential interlocking directorate issues can arise in a variety of contexts, including where:

- A company or private equity firm takes a minority stake in a competitor.
- A corporation enters a new product area that places it in competition with another corporation.

Companies often choose to address the issue proactively by foregoing a board seat or eliminating the interlock, sometimes even before there are actual competing sales. For example, an executive of Alphabet Inc., the parent company of Google Inc., resigned from Uber Technologies Inc.'s board when the two companies began to pursue similar businesses. Both Alphabet and Uber were focusing on overlapping areas, such as mapping technology, ride-sharing, and self-driving vehicles. (See Mike Isaac, *Uber and Alphabet's Rivalry Heats Up as Director Chooses Sides*, N.Y. Times (Aug. 29, 2016).)

This article provides an overview of antitrust violations that can be caused by interlocking directorates and discusses related enforcement actions. In particular, it examines:

- The application of Section 8 and elements of a Section 8 claim.
- The exceptions to, exclusions from, and limitations of Section 8.
- The remedies available for Section 8 violations.

APPLICATION OF SECTION 8

Section 8 prohibits any person from serving simultaneously as an officer or a director of two competing corporations that are engaged in commerce, so that an agreement between them eliminating competition would violate the antitrust laws (15 U.S.C. § 19(a)(1)).

Violations of Section 8 are per se violations, meaning that a lack of competitive injury will not excuse the parties from liability unless one of the *de minimis* exemptions in the statute applies (see J. Thomas Rosch, Comm'r, FTC, Remarks Before the University of Hong Kong, *Terra Incognita: Vertical and Conglomerate Merger and Interlocking Directorate Law Enforcement in the United States*, at 17-18 (Sept. 11, 2009) (Rosch Remarks); see below *De Minimis Exceptions*).

Enforcement actions against interlocking directorates under Section 8 may be brought by:

- Governmental enforcement agencies, such as the Federal Trade Commission (FTC) and the Department of Justice (DOJ).
- State attorneys general.
- Private parties.

To determine whether Section 8 applies to an interlocking directorate, counsel must evaluate whether:

- The two corporations are engaged in commerce.
- The two corporations compete with one another by virtue of their business or location.
- A person serves as an officer, meaning an individual elected or chosen by the board of directors, or a director of the two corporations.

Additionally, each corporation's financial records must show that it has capital, surplus, and undivided profits aggregating $32,914,000 or more, as adjusted annually by the FTC based on changes in the gross national product. (15 U.S.C. § 19(a).)

COMMERCE TEST

The commerce test is met if both corporations are engaged in whole or in part in commerce, including either:

- Interstate commerce.
- US commerce with foreign countries.

(15 U.S.C. §§ 12(a), 19(a).)

To determine whether Section 8 applies to an interlock involving a non-US corporation, counsel should consider whether the corporation is engaged in commerce with or within the US.

Other Applicable Antitrust Statutes

In addition to Section 8 of the Clayton Act, the federal antitrust enforcement agencies may use other antitrust statutes to challenge interlocking directorates. These include:

- **Section 5 of the FTC Act.** Section 5 prohibits unfair methods of competition (15 U.S.C. § 45). Often, the FTC alleges a violation of Section 8 together with a violation of Section 5 (see *TRW, Inc. v. FTC*, 647 F.2d 942, 945 n.1 (9th Cir. 1981); *In re Borg-Warner Corp.*, 101 F.T.C. 863, 1983 WL 486332, at *1 (1983), modified, 102 F.T.C. 1164 (1983), rev'd *sub nom. Borg-Warner Corp. v. FTC*, 746 F.2d 108 (2d Cir. 1984)). (For more information, search FTC Act Section 5: Overview on Practical Law.)
- **Section 1 of the Sherman Act.** Section 1 prohibits agreements that unreasonably restrain trade (15 U.S.C. § 1). In rare cases, interlocking directorates have been challenged under Section 1 as enabling a conspiracy through the exchange of information (see *Perpetual Fed. Sav. & Loan Ass'n*, 90 F.T.C. 608, 657 (1977), withdrawn, 94 F.T.C. 401 (1979)). (For more information, search Establishing an Agreement Under Section 1 of the Sherman Act on Practical Law.)

The government also has alleged Section 8 violations alongside allegations that a merger violates Section 7 of the Clayton Act, which prohibits mergers and acquisitions where the effect might substantially lessen competition (15 U.S.C. § 18; Complaint at 2, *United States v. CommScope, Inc.*, No. 07-02200, 2007 WL 4535874 (D.D.C. Dec. 6, 2007); see below *Restructuring a Transaction*).

COMPETITION BETWEEN THE CORPORATIONS

Section 8 violations generally occur between two corporations that compete directly. However, a violation also can occur when the two corporations of which a person is an officer or a director compete in either of the following ways:

- Subsidiaries of the two corporations compete.
- One corporation competes with the subsidiary of the other corporation.

(See *Square D Co. v. Schneider S.A.*, 760 F. Supp. 362, 366-67 (S.D.N.Y. 1991).)

Courts have inconsistent views about how to treat situations involving competition and subsidiaries (see *Box, A Case in Point: Competition and Subsidiaries*). For example, courts have considered whether:

- The parent corporation controls the subsidiary, including by dictating the subsidiary's policies or through a series of other factors that suggest control.

- The subsidiary is a wholly owned subsidiary of the parent, and functions as a single entity or economic unit with its parent.

Degree of Control: Policies

If an interlock involves a corporation that competes with the subsidiary of another corporation, a court generally examines whether the business of the subsidiary can be attributed to that subsidiary's parent.

To do this, most courts assess the extent of a parent corporation's control over its subsidiary. Specifically, these courts will scrutinize whether the parent corporation closely controls or dictates the policies of the subsidiary (see *United States v. Crocker Nat'l Corp.*, 656 F.2d 428, 450 (9th Cir. 1981), rev'd *sub nom. BankAmerica Corp. v. United States*, 462 U.S. 122 (1983); *Reading Int'l*, 317 F. Supp. 2d at 324; *Square D*, 760 F. Supp. at 367-68; *United States v. Cleveland Trust Co.*, 392 F. Supp. 699, 712 (N.D. Ohio 1974)).

Degree of Control: Other Factors

There is no definitive list of factors for assessing the degree of control a parent has over its subsidiary to determine if there is a Section 8 violation involving one corporation that competes with the subsidiary of another. The FTC has evaluated whether:

- The parent elects and nominates the subsidiary's directors.
- The directors of the parent and subsidiary overlap.
- The subsidiary corporation:
  - is wholly owned;
  - submits financial reports and business plans to the parent;
  - markets products on behalf of the parent;
  - has access to the parent's research and development plans; or
  - relies on the parent for capital contributions.
- The subsidiary's business is the subject of the parent's boardroom deliberations and, if so, to what extent.
- Officers of the two corporations discuss issues that involve potential cooperation relating to the subsidiary's activities, showing that the temptation to engage in anticompetitive behavior is already close at hand.
- An interlocked director can exercise control over, or substantially influence, decision-making at the board level so that there is a likelihood of collusion or an anticompetitive information exchange.

(See *Borg-Warner*, 1983 WL 486332, at *35, *49-51.)

One court has evaluated whether the parent has control in fact of the subsidiary, such as under a statute, in determining whether two corporations compete under Section 8 (*Crocker Nat'l*, 656 F.2d at 450 (finding that a parent bank holding company had a conclusive presumption of control over its bank subsidiaries under the Bank Holding Company Act)).

Functioning as a Single Entity

Several courts have found that Section 8 does not apply to an interlock between two entities that are akin to a parent corporation and its wholly owned subsidiary because a parent and wholly owned subsidiary cannot agree to eliminate competition in violation of the antitrust laws. These decisions follow the US Supreme Court's opinion in *Copperweld Corp. v. Independence Tube Corp.*, which held that a parent company and its wholly owned subsidiary were a single economic unit and incapable of conspiring with each other to violate Section 1 of the Sherman Act (467 U.S. 752, 771-72 & n.18 (1984)).

For example, in *HealthAmerica Pennsylvania, Inc. v. Susquehanna Health System*, the plaintiff alleged that interlocks in violation of Section 8 had been formed between the boards of Susquehanna Regional Healthcare Alliance (Alliance), which comprised two health systems, and Alliance's member hospitals. The court found that Alliance could not compete with its member hospitals because together they functioned as a single legal entity. Although its structure was unique, Alliance's composition was similar to that of a corporate parent and its subsidiaries. Because Alliance and its member entities were not competitors, the interlock did not violate Section 8. (278 F. Supp. 2d 423, 434-37, 440-41 (M.D. Pa. 2003).)

DEFINITION OF PERSON

The antitrust agencies and some courts have interpreted Section 8's use of the word "person" to include corporations, under a deputization or an agency theory (see *Reading Int'l*, 317 F. Supp. 2d at 327-28; *Square D*, 760 F. Supp. at 366-67). The Clayton Act's definition of person includes corporations, further supporting that interpretation (15 U.S.C. § 12(a); see Rosch Remarks, at 19 n.55).

If an interlock involves a corporation that competes with the subsidiary of another corporation, a court generally examines whether the business of the subsidiary can be attributed to that subsidiary's parent.

A Case in Point: Competition and Subsidiaries

Courts have differed on the treatment of indirect interlocks involving competition among subsidiaries, in part because a fact-specific analysis informs whether anticompetitive harm is likely. For example, in *Kennecott Copper Corp. v. Curtiss-Wright Corp.*, the Second Circuit stated that it would not adopt a general rule that prohibits interlocking directorates between two parent companies with subsidiaries that compete. However, the court left open the possibility that Section 8 might apply to a parent corporation that closely controls its subsidiary. (584 F.2d 1195, 1205 (2d Cir. 1978); see also *Square D*, 760 F. Supp. at 367.)

Other courts have held that a parent corporation is not a competitor of another corporation simply because that corporation has a subsidiary that competes. Instead, the parent corporations must themselves compete. For example, in *Paladin Associates, Inc. v. Montana Power Co.*, the court stated that to find a violation of Section 8, a plaintiff must show that the corporations on whose boards the directors sit actually compete (97 F. Supp. 2d 1013, 1031 (D. Mont. 2000)).

The FTC and DOJ have found indirect interlocks involving subsidiaries where the positioning of the director likely would create an opportunity for anticompetitive harm. For example, Section 8 might be violated if the parent corporation controls or closely supervises the subsidiary, because then an interlock between the subsidiary and a competing corporation could result in anticompetitive effects. (See *Borg-Warner*, 1983 WL 486332, at *33-36; *United States v. Bam*, 1976-1 Trade Cas. (CCH) ¶ 60,734, 1976 WL 1209, at *1 (D. Conn. 1976); *United States v. Cooper*, 1976-1 Trade Cas. (CCH) ¶ 60,952, 1976 WL 1277, at *1 (S.D. Tex. 1976).)

As a result, liability might exist where two different agents or representatives of a corporation serve as officers or directors of two competing corporations. This might be the case where, for example:

- Corporations A, B, and C are competitors.
- One agent of Corporation A sits on Corporation B's board and another agent of Corporation A sits on Corporation C's board.

In this situation, the agents are considered deputies of the corporation and treated as the same person (the corporation) under Section 8. Further, in *Square D*, the court interpreted Section 8 to extend to employees, rather than strictly officers and directors, based on an agency theory (760 F. Supp. at 367-68; see *Box, A Case in Point: The Agency Theory*).

In the *Reading International* case, the court found that the deputization theory applies where agents are acting not in their individual capacities, but as instrumentalities of the company (317 F. Supp. 2d at 331). Other courts have mentioned this theory of liability but have not necessarily adopted it (see *Pocahontas Supreme Coal Co. v. Bethlehem Steel Corp.*, 828 F.2d 211, 217 (4th Cir. 1987); *Cleveland Trust*, 392 F. Supp. at 710-12).

EXCEPTIONS, EXCLUSIONS, AND LIMITATIONS

Despite Section 8's seemingly broad reach, there are several safe harbors and exceptions that counsel should consider when assessing whether a violation might exist. For example, Section 8:

- Provides a one-year grace period following an intervening event that creates an interlocking directorate violation.
- Contains exceptions for competing sales that are below certain thresholds.
- Does not apply to certain types of interlocks that might violate other antitrust laws, such as vertical interlocks.
- Does not apply to most non-corporate entities, such as partnerships.

ONE-YEAR GRACE PERIOD

A grace period applies to any officer or director who serves in a position that forms an interlocking directorate where:

- The person was eligible to serve in that position at the time of election, meaning that person's participation was lawful under Section 8.
- The person becomes ineligible for that position due to an intervening event that makes continued participation unlawful under Section 8, such as:
  - a change in one of the corporation's capital, surplus, and undivided profits that causes it to exceed the threshold for exemption; or
  - a development that causes the two corporations to become competitors.

The officer or director has a one-year grace period from the date of the intervening event to resign from that position (15 U.S.C. § 19(b)).

As a practical matter, counsel should address a potential interlock issue as swiftly as possible. Even though Section 8 may not prohibit the interlock during the grace period, the antitrust agencies may investigate or seek enforcement under Section 1 of the Sherman Act or Section 5 of the FTC Act if there are potential anticompetitive effects, such as information exchanges (see *Box, Other Applicable Antitrust Statutes*).

DE MINIMIS EXCEPTIONS

There are *de minimis* exceptions to Section 8's prohibitions on interlocking directorates where competition between the companies is limited. These exceptions focus on the parties' competitive sales, meaning the gross revenues for all products and services sold by one corporation in competition with another corporation.

Specifically, Section 8 does not apply if any of the following is true:

- Either corporation's competitive sales are less than $3,291,400, as adjusted annually by the FTC based on changes in the gross national product.

A Case in Point: The Agency Theory

In *Square D Co. v. Schneider S.A.*, Square D alleged that Schneider, its competitor, planned to engage in a proxy fight to control Square D's board. Square D alleged that Schneider had proposed 11 candidates for Square D's board, all of whom were employees, officers, directors, or consultants of either Schneider or its subsidiaries.

Schneider conceded that one nominee sat on the board of a Schneider subsidiary that competed with Square D, but alleged that the remaining ten nominees were not officers or directors under Section 8.

Square D alleged that all of the nominees were Schneider's agents and their election to Square D's board would violate Section 8 because:

- Schneider was a person under Section 8.
- Some of Schneider's subsidiaries competed with Square D, and Schneider would then have agents on both Square D's and its competitors' boards.

The court declined to read Section 8 literally to find that an agent is not an officer or a director, because this reading would allow a company to evade Section 8 liability merely by using a term other than "officer" or "director" to describe its agents.

The court instead found that a Section 8 violation exists where a company attempts to place on a competitor's board individuals who are agents of, and have an employment or business relationship with, that company. The court stated that its decision supported the policies underlying Section 8, including preventing the coordination of business decisions by competitors and the exchange of commercially sensitive information. (760 F. Supp. at 364, 366-67.)

- Either corporation's competitive sales are less than 2% of that corporation's total sales (meaning its gross revenues for all products and services in the most recent fiscal year).
- Each corporation's competitive sales are less than 4% of its total sales.

Competitive sales are defined using the annual gross revenues for those products and services in the most recent fiscal year. (15 U.S.C. § 19(a)(2).)

The antitrust agencies still may use Section 5 of the FTC Act and Section 1 of the Sherman Act to challenge interlocks that fall within Section 8's exceptions, although they have never done so.

EXCLUDED INTERLOCKS

Section 8 applies to interlocks between competitors (known as horizontal interlocks). It does not apply to certain types of interlocks that might violate other antitrust laws, including interlocks:

- Between suppliers and customers (known as vertical interlocks).
- Between potential competitors.
- Involving entities other than corporations, such as partnerships (see below *Application to Other Entities*).
- Involving related individuals or close friends.
- Where individuals from competing corporations both sit on a board of a non-competing company.

(See Rosch Remarks, at 18.)

The FTC has reserved judgment on whether it may challenge interlocks involving suppliers and customers or potential competitors under Section 8 or Section 5 of the FTC Act (see *TRW*, 647 F.2d at 946 n.4; *In re TRW, Inc.*, 93 F.T.C. 325, 1979 WL 199199, at *43 n.12 (1979)).

APPLICATION TO OTHER ENTITIES

Section 8 explicitly applies to interlocking directorates among corporations. This extends to non-US corporations because the Clayton Act defines a person to include corporations or associations existing under or authorized by the laws of any foreign country (15 U.S.C. § 12(a)).

However, the Clayton Act does not define the term "corporation" and, therefore, Section 8 does not apply to non-corporate entities, such as partnerships. Section 8 also might not apply, or might have limited applicability, to limited liability companies (LLCs). Additionally, Section 8 carves out an exception for interlocking directorates involving banks, banking associations, and trust companies.

Limited Liability Companies

Some commentators have noted that Section 8 may not apply to LLCs, which are treated sometimes as corporations and sometimes as non-corporate entities (see Julian O. Von Kalinowski et al., Antitrust Laws and Trade Regulation § 35.03[2][a] (2d ed. 2013)).

While there are no court or agency opinions discussing this topic, the antitrust agencies treat LLCs as non-corporate entities under Section 7A of the Clayton Act, also known as the Hart-Scott-Rodino Act, and related rules (16 C.F.R. § 801.1(f)(1)(ii)).

As a result, if one or both of the interlocking companies are LLCs, there might be a technical argument that Section 8's prohibition on interlocking directorates does not apply. However, the government still can rely on other antitrust statutes, including Section 5 of the FTC Act or Section 1 of the Sherman Act.

Banks, Banking Associations, and Trust Companies

The Section 8 prohibition on interlocking directorates does not apply to interlocks involving banks, banking associations, and trust companies, meaning interlocks between:

- Two banks.
- A bank and a competing non-bank.

(See *BankAmerica*, 462 U.S. at 128.)

Search Management Interlocks for information on the laws and regulations restricting the ability of bank management officials to serve as management officials in a competing banking organization.

REMEDIES FOR SECTION 8 VIOLATIONS

The following remedies are available in Section 8 actions:

- Injunctive relief sought by:
  - the FTC under Section 11 of the Clayton Act;
  - the DOJ under Section 15 of the Clayton Act; or
  - private plaintiffs under Section 16 of the Clayton Act.
- Damages sought by private plaintiffs under Section 16 of the Clayton Act, although no court appears to have awarded these damages yet.

(15 U.S.C. §§ 21, 25, 26.)

Occasionally, relief may consist of a prohibition on future interlocks. However, antitrust agency or judicial relief usually requires:

- Elimination of the interlock.
- Restructuring a transaction to:
  - eliminate a board seat that creates an interlock; and
  - include prior notification or approval provisions regarding the appointment of future officers or directors.

INJUNCTIVE RELIEF

A plaintiff seeking injunctive relief under Section 8 must show that there is a cognizable danger of a recurrent violation (see *United States v. W.T. Grant Co.*, 345 U.S. 629, 633 (1953)).

For example, in *Borg-Warner*, the FTC obtained an order enjoining Borg-Warner Corp. and its competitors in the automotive parts business, Bosch GmbH and Bosch U.S., from having interlocking directorates for a period of ten years (1983 WL 486332, at *88). However, the Second Circuit overturned the cease-and-desist order on appeal, finding that Borg-Warner Corp. had sold its automotive parts business and there was little possibility that it would re-enter that business. Therefore, the court concluded that the FTC had not met its burden of showing a danger of a recurring Section 8 violation. (746 F.2d at 110-11.)

ELIMINATION OF THE INTERLOCK

The antitrust agencies may require officers or directors to resign, or those individuals may voluntarily resign, to eliminate a possible interlocking directorate.

For example, in the FTC's investigation of a potential interlock between Google and Apple, resignations from the companies' boards eliminated the possible interlock. The Chairman of the FTC at the time, Jon Leibowitz, commended the companies for recognizing that their shared directors raised serious antitrust issues and for their willingness to resolve the agency's concerns without litigation. (See Press Release, FTC, Statement of FTC Chairman Jon Leibowitz Regarding the Announcement that Arthur D. Levinson Has Resigned from Google's Board (Oct. 12, 2009); Press Release, FTC, Statement of Bureau of Competition Director Richard Feinstein Regarding the Announcement that Google CEO Eric Schmidt Has Resigned from Apple's Board (Aug. 3, 2009).)

However, the resignation of a problematic director might not be enough to render a case moot if the potential for future interlocks remains, for example, from ownership rights that include the ability to appoint a director.

RESTRUCTURING A TRANSACTION

Interlocking directorate issues can arise in the transactional context through:

- Mergers.
- Investments (partial acquisitions).
- Private equity portfolio company holdings.

The government may require parties to these transactions to restructure a deal to avoid a Section 8 violation.

The resignation of a problematic director might not be enough to render a case moot if the potential for future interlocks remains, for example, from ownership rights that include the ability to appoint a director.

For example, the DOJ announced that Tullett Prebon Group Ltd.'s $1.5 billion acquisition of ICAP plc's hybrid voice broking and information business would be restructured to address the DOJ's concerns that it violated Section 8 by creating an interlocking directorate. Although Tullett Prebon and ICAP would continue as competitors in certain business areas, ICAP had planned to obtain a 19% interest in the enlarged Tullett Prebon as part of the acquisition and gain the right to appoint one director to the Tullett Prebon board. As restructured, ICAP has no post-acquisition ownership interest in Tullett Prebon. (See Press Release, DOJ, Tullett Prebon and ICAP Restructure Transaction After Justice Department Expresses Concerns about Interlocking Directorates (July 14, 2016); Press Release, Tullett Prebon plc, Update on the Proposed Acquisition of ICAP's Global Hybrid Voice Broking and Information Business (June 21, 2016).)