

Don't Get Tangled Up With Interlocking Directorates

Every so often, a company gets wrapped up in interlocking directorate trouble. When that happens, companies come under the antitrust microscope of the Federal Trade Commission and Department of Justice. And often, when the antitrust agencies have a company in their sight, they will ask themselves: what other antitrust compliance issues might be lurking? The answer may result in a costly (legal fees, fines and penalties) and disruptive (private plaintiff litigation) antitrust investigation, along with the baggage (reputational damage, shareholder questions) that often comes with it. Following is a brief description of the interlocking directorate concern, and some simple steps you can take to avoid the issue.

Section 8

An interlocking directorate is when an officer or director of one company also acts as an officer or director of a competing company. Section 8 of the Clayton Act prohibits interlocking directorates. The statute provides: “[n]o person shall, at the same time, serve as a director or officer in any two corporations ... that are ... competitors such that the elimination of competition by agreement between them would constitute a violation of any of the antitrust laws.” Thus, Section 8 forbids any person from simultaneously serving as a director or officer in any two corporations (excluding banks, banking associations and trust companies), which by virtue of their business and location of operation are competitors, and the elimination of competition by agreement between them would constitute a violation of any of the antitrust laws.

Section 8 liability is a strict liability statute. Liability is determined irrespective of intent. No demonstration of an effect on prices, output, or competition is required.

Antitrust regulators have taken the position that Section 8 applies to corporations, not just specific individuals. Courts have supported this position. One court wrote, for example, “a cause of action under § 8 is stated where a company attempts to place on the Board of a competitor individuals who are agents of, and have an employment or business relationship with, such company.”

Private equity firms and other firms with multi-tiered corporate structures should be especially cautious of violating Section 8. The antitrust laws are clear that parents and wholly-owned subsidiaries cannot conspire, but less clear when it comes to partially-owned subsidiaries and affiliates.

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Exemptions

There are certain statutory exemptions to Section 8's prohibitions. There are certain minimal thresholds that must be met. Each company must have capital, surplus, and undivided profits (equity) aggregating to more than \$27,784,000. Companies under the same umbrella are not aggregated for determining whether the threshold is met. These monetary thresholds are increased or decreased as of October 1 each year by an amount equal to the percentage increase (or decrease) in the gross national product.

Simultaneous service as a director or officer in two corporations is also not prohibited if the competitive sales¹ of either corporation are less than \$2,778,400, the competitive sales of either corporation are less than 2 percent of that corporation's total sales, or the competitive sales of each corporation are less than 4 percent of that corporations total sales.

The statute does not cover interlocks between potential competitors or vertical interlocks, nor does it prohibit agents of two competing companies from acting as directors or officers for the same non-competing company.

Additional Risks

In addition to creating a problem under Section 8, an interlocking directorate may pose risk under Section 1 of the Sherman Act. Information exchange concerns can arise where the officer or director is exposed to the competitively sensitive information of both companies.

FTC Commissioners have stated that to the extent that the interlocks not covered by Section 8 pose a competitive problem, those situations may be actionable under Section 5 of the FTC Act.

Remedies

The penalties for violating Section 8 often do not involve monetary fines, but rather focus on elimination of the interlock. There is also a private right of action for a Section 8 claim, although to date private plaintiffs have not been successful in obtaining monetary relief and have only obtained injunctions to stop overlapping directors from serving. But companies violating Section 8 can also face Sherman Act liability and the potential for private plaintiffs to bring lawsuits seeking treble damages and attorneys' fees still exists.

Avoidance

Companies should be wary of Section 8 issues when entering into mergers or joint ventures. While there may be no competitive overlap between two transacting companies, if one transacting party is a director or officer of a third company that competes with the other transacting party, Section 8 may be implicated. Thus, a company can merge into a Section 8 issue.

Companies in rapidly transforming industries should be cautious of Section 8 issues. Markets evolve, especially in the technology sector. Today's non-competing companies may become competitors tomorrow, such that common directors or officers might violate Section 8 (this happened to Eric Schmidt when he sat on the board of both Google and Apple!). The same caution applies to businesses that initially fall below the jurisdictional thresholds, but have the potential to exceed the thresholds in later years.

¹ Competitive sales is defined as the gross revenues for all products and services sold by one corporation in competition with the other, determined on the basis of annual gross revenues for such products and services in the corporation's last completed fiscal year. Total sales is defined as the gross revenues for all products and services sold by one corporation over that corporation's last completed fiscal year.

There is no exemption for foreign corporations. Foreign corporations with significant US business should ensure compliance with Section 8.

Three simple steps to make sure your company does not fall prey to interlocking director liability:

- Have a policy in place requiring employees to notify the compliance office and/or legal department when they are an officer or director of another company or organization and educate each employee that is an officer or director of a company about the implications of Sections 8 (and information sharing under Section 1 of the Sherman Act).
- Identify the subsidiaries and affiliates of your company where the company holds less than 100% ownership and ensure there are no interlocking directorates if the subsidiary, affiliate or portfolio company is a competitor.
- Add a Section 8 review to your merger control and due diligence checklist.



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