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Insights

Antitrust Practice Group

Behind the Section 8-Ball: What You (and Your Board) Need to Know About Antitrust Scrutiny of Director and Officer Appointments

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Contact

Fiona Schaeffer, Partner
+1 212.530.5651
fschaeffer@milbank.com

Adam Di Vincenzo, Partner
+1 202.835.7510
adivincenzo@milbank.com

Richard Parker, Partner
+1 202.835.7530
rparker@milbank.com

Grant A. Bermann, Partner
+1 202.835.7515
gbermann@milbank.com

Daniel Rosenthal, Special Counsel
+1 202.835.7519
drosenthal@milbank.com

Lauren Knoke, Associate
+1 212.530.5109
lknoke@milbank.com

Since 1914, Section 8 of the Clayton Act has prohibited the same individual (or, arguably, agents of the same company) from serving as officers of or directors on the boards of competing companies, unless such a director or officer "interlock" qualifies for an exemption. The prohibition has evolved over time through amendments and court rulings. But, until recently, the antitrust agencies had seldom acted against such interlocks.

Under the Biden Administration, that has changed. Last October, the US Department of Justice, Antitrust Division ("DOJ") announced that seven directors resigned from the boards of five companies in response to concerns the DOJ raised about the directors' service on the boards of competing companies. Assistant Attorney General Kanter signaled at the time that the DOJ would be "undertaking an extensive review of interlocking directorates across the entire economy." Several months later, the DOJ announced the resignation of five more directors from four corporate boards (and one more company announced a withdrawal of a board nominee). Then, this past August, the DOJ announced that two directors of Pinterest Inc. resigned from their positions on the board of Nextdoor Holdings Inc. The DOJ's Section 8 enforcement initiative has now led to 15 interlocking director resignations from 11 different boards since late 2022.

The Federal Trade Commission ("FTC") has also joined the fray. In August, it announced a proposed consent order between Quantum Energy Partners ("Quantum"), a private equity firm, and EQT Corporation ("EQT"), an independent natural gas producer, for a proposed transaction that included a seat for Quantum on EQT's board of directors. The FTC alleged that the inclusion of the board seat violated Section 8 (i.e., an "interlocking directorate"), as both companies and their affiliates compete head-to-head in the production of natural gas in the Appalachian Basin. The FTC's final order (approved on October 10) prohibits Quantum from occupying a seat on EQT's board to "prevent the formation of an interlocking directorate." The Quantum/EQT consent order marks the FTC's first formal Section 8 enforcement in nearly 40 years.

The DOJ's and FTC's expanded enforcement of Section 8 is proceeding in tandem with the proposed reforms to the HSR Notification and Report Form announced in June. These reforms, if implemented, would require filing parties to disclose far more information about the entities they own, including information regarding the boards on which their officers and directors serve. The FTC and DOJ likely plan to use this information to uncover possible Section 8 violations.

US antitrust enforcers also appear to be taking a more expansive view of which interlocks are unlawful. Today, the boards of all types of entities are subject to scrutiny, from publicly traded corporations to privately held companies and their private equity sponsors.

So, what do in-house counsel need to know to navigate this environment?

Clayton Act Section 8: The Basics

Section 8 prohibits directors and officers of a corporation from serving simultaneously on the boards of two or more competing corporations, unless one or more specified exceptions apply.

Section 8 may apply if the following criteria are met:

1. A "person" serves as an officer, meaning an individual elected or chosen by the board of directors, or a director of the two corporations;
2. The two corporations with interlocking directors or officers are engaged in commerce;
3. The two corporations compete with one another "by virtue of their business and location of operation" (in other words, generally speaking, the two corporations compete in the same market); and
4. None of the enumerated exemptions apply. For example, an officer or director interlock is generally exempt from Section 8 if:
    a. Each corporation has "capital, surplus, and undivided profits" aggregating less than $45,257,000 (as adjusted annually by the FTC based on changes in the gross national product);
    b. The competitive sales of *either* corporation are less than $4,525,700;
    c. The competitive sales of *either* corporation are less than 2% of the corporation's total sales; or
    d. The competitive sales of *each* corporation are less than 4% of the corporation's total sales.

Section 8 also provides for a one-year grace period if a business development makes an individual officer or director ineligible to serve. For example, if Company A acquires a new product that puts it in competition with Company B, and a Company A director serves on the board of Company B, the interlock remains lawful for one year after the acquisition. This grace period does not apply unless the director or officer was eligible to serve as a director when he or she was first appointed.

Interlocking directorates are *per se illegal*, meaning that the antitrust agencies do not need to establish anticompetitive harm from the interlock. On the other hand, monetary damages have never been awarded for a Section 8 violation. The typical remedy is for the interlock to be removed by having a director step down from one of the interlocking boards.

What Types of Entities Are Covered?

Recent FTC and DOJ actions continue to add to the uncertainty over what types of business structures and entities are covered by Section 8. The enforcers appear to take the position that *all* types of entities are covered, including not only corporations, but limited liability companies ("LLCs") or partnerships (including general partnerships ("GPs") and limited partnerships ("LPs")). The agencies' position marks a significant departure from their longstanding practice and, according to some court rulings, the statute itself.

Section 8 of the Clayton Act applies only to interlocks between "two *corporations.*"[i] The use of the term "corporations" in the statute suggests, at a minimum, that Congress intended that Section 8 only apply to certain types of entities and not others, and that it not apply to the boards of non-corporate entities. The Supreme Court observed that when it comes to interpreting Section 8, "[t]he starting point, as always, is the language of the statute."[ii] The statutory language made it clear, according to the Court, that Congress intended to "limit both the classes of corporations and the kinds of interlocks subject to [Section 8]." For example, Congress used the term "person" to describe the coverage of other provisions of the Clayton Act (Sections 2, 3, 4, 7, 10, and 11), showing that it knew how to cover a broader range of entities than

"corporations" when it so desired, but opted not to cover a broader range of entities when targeting board interlocks in Section 8.

Nevertheless, Lina Khan, Chair of the FTC, said in a statement that the proposed EQT order "puts industry actors on notice that they must follow Section 8 *no matter what specific corporate form their business takes*." Khan further stated that "Section 8's specific prohibition of interlocks among competitor 'corporations' pre-dates the development of other commonly used corporate structures."

Given the apparent conflict with the statute's text, the FTC's position that all entities are covered by Section 8 might not be adopted by the courts. However, firms are, in Chair Khan's words, "on notice" that the agencies view Section 8 as covering LLCs, partnerships, and other non-corporate entities. This posture presents new enforcement risks for private equity firms, which frequently use LLCs, GPs, and similar entities to structure their holdings.

Does Section 8 Prohibit Entities (Including Private Equity Sponsors) from Appointing Representatives on the Boards of Competitors?

Another unresolved issue confronting private equity firms is the extent to which Section 8 prohibits a single entity from appointing representatives (or "deputies") to the boards of competing companies. This "deputization" issue might arise, for example, where a private equity firm manages one or more funds that own all or part of portfolio companies that compete with each other. At least one court applying Section 8 has suggested that an entity that controls a board seat through an agent or deputy "serves" on the board, meaning that a single entity can violate Section 8 by appointing two different individuals to the boards of competing firms.[iii] However, courts have yet to provide clear guidance as to when, specifically, the deputization theory would apply, if at all.

On the other hand, if companies that share a common director (or have board members appointed by the same entity) are part of the same corporate family, there may be a *Copperweld* defense to Section 8. Section 8 does not apply to an interlock between a parent and its wholly owned subsidiary because a parent and its subsidiary are not separate entities, and thus, are not capable of conspiring under the Supreme Court's *Copperweld* decision.[iv] However, private equity companies should be aware that the US antitrust agencies may assert that only interlocks concerning wholly owned subsidiaries can benefit from the *Copperweld* defense. Depending on the facts, they might still attempt to apply Section 8 to interlocks involving subsidiaries of which the parents own less than 100 percent or if the subsidiaries are owned by different funds.

Does Section 5 of the FTC Act Prohibit Interlocking Directorates?

In the Quantum/EQT complaint, the FTC provided a clue as to how it plans to implement its expansive view of Section 8: it alleged that the interlock violated Section 5 of the FTC Act, which broadly applies to "unfair methods of competition." According to the FTC, the interlock between Quantum and EQT created the potential for competitive harm because it facilitated the exchange of confidential and competitively significant information. This follows a November 2022 FTC policy statement stating its intention to increase its enforcement of Section 5 of the FTC Act, including interlocking directorates. The EQT consent order may indicate that the FTC intends to follow through on its plan to expand Section 5's reach to board interlocks between entities other than corporations, even if courts hold that Section 8 of the Clayton Act would not reach such interlocks.

What Steps Can Be Taken Now to Avoid Interlocks Issues?

With the US antitrust agencies continuing to focus on potential interlocking directorates, companies should ensure that they are aware of any potential interlocks through a comprehensive director and officer compliance policy. This could include:

- Verifying during the onboarding process whether any new officers or directors hold board positions at other institutions (including minority holdings) that could be viewed as competitors;
- Requiring an annual certification by the company's managing directors (and other personnel, if appropriate) reporting on any board seats they hold (whether acting as an agent for the firm or otherwise);
- Monitoring new products or services, particularly for those corporations with changing or dynamic businesses to ensure a new interlock will be detected;
- Implementing information firewalls to ensure any interlocks, or other relationships between competing portfolio companies, do not lead to other antitrust issues; and
- Considering potential interlocks as part of the company's antitrust analysis in connection with IPOs and M&A activity.

Practice/Group Contacts

New York	55 Hudson Yards New York, NY 10001	
Fiona Schaeffer	fschaeffer@milbank.com	+1 212.530.5651
Lauren Knoke	lknoke@milbank.com	+1 212.530.5109
Washington, DC	1850 K Street, NW Suite 1100 Washington, DC 20006	
Adam Di Vincenzo	adivincenzo@milbank.com	+1 202.835.7510
Richard Parker	rparker@milbank.com	+1 202.835.7530
Grant Bermann	gbermann@milbank.com	+1 202.835.7515
Daniel Rosenthal	drosenthal@milbank.com	+1 202.835.7519

Please feel free to discuss any aspects of this Client Alert with your regular Milbank contacts or any member of our Antitrust Practice Group.

[i] 15 USC. § 19(a)(1).
[ii] *BankAmerica Corp. v. United States*, 462 US 122, 128 (1983).
[iii] *Reading Intern, Inc. v. Oaktree Cap. Mgmt.*, 317 F. Supp. 2d 301, 327-328 (S.D.N.Y. 2003).
[iv] *Copperweld Corp. v. Indep. Tube Corp.*, 467 US 752, 771-74 (1984).