Sidley Perspectives ON M&A AND CORPORATE GOVERNANCE

ANALYSIS

INTERLOCKING DIRECTORATE CONSIDERATIONS IN M&A AND PROXY CONTESTS

By Karen Kazmerzak and Jim Lowe[1]

The U.S. economy's recovery has led to increased deal flow for mergers, acquisitions, minority and co-investments, and SPACs. With these transactions, as with shareholder activism, board seats are often in play, which brings the potential for board interlocks that may create antitrust issues. This article offers a refresher on the antitrust considerations for evaluating the suitability of director appointments.

Interlocking directorate issues may arise when a person serves as an officer or director of two competing companies. In a proxy contest, activist investors should ensure that their candidates do not have any interlocking directorate issues, like in the recent proxy contest launched by activist investor Ancora Holdings, Inc. against Blucora, Inc. *Press Release*, Blucora, Inc., "*Acclaimed Antitrust Expert Believes Ancora CEO Fred DiSanto Cannot Serve on Blucora's Board of Directors*" (Apr. 12, 2021).[2] The issue can also arise in connection with deals cleared by the U.S. antitrust agencies. *Press Release*, Dep't of Justice, "*Tullett Prebon and ICAP Restructure Transaction after Justice Department Expresses Concerns about Interlocking Directorates*" (July 14, 2016) (allowing partial investment between parties under Section 7 of the Clayton Antitrust Act, but requiring the parties to remove director interlock). Most recently, two executives stepped down from a board after the Department of Justice (DOJ) expressed concerns that the appointments created an illegal director interlock between two companies that compete in ticket sales in sports and entertainment markets. *Press Release*, Dep't of Justice, "*Endeavor Executives Resign from Live Nation Board of Directors after Justice Department Expresses Antitrust Concerns*" (June 21, 2021).

Section 8 of the Clayton Act is the primary antitrust enforcement mechanism limiting service of directors and officers on boards. 15 U.S.C. § 19. Two other statutes may also be enforced to prohibit or limit board interlocks. Section 1 of the Sherman Act, 15 U.S.C. § 1, prohibits director interlocks that unreasonably restrain trade, and Section 5 of the Federal Trade Commission (FTC) Act, 15 U.S.C. § 45, may prohibit a director interlock as an unfair method of competition. Even where an interlock does not constitute a technical violation of Section 8, it may raise issues under Sections 1 or 5 if the common director on the boards of competing corporations would have access to competitively sensitive information of either or both companies.

The interlocking directorate prohibition was enacted due to concerns that competitors could use boardroom activities to facilitate collusion.

Unlike Sections 1 and 5, a violation of Section 8 is a per se offense, meaning that if the conduct fits squarely within the statute, that conduct is unlawful. The result of finding a violation is that the interlock must be dissolved by the person creating the interlock leaving at least one of the boards. It is not possible to solve the Section 8 issue by recusing the interlocking director from meetings, decisions and other communications that relate to the competitive overlaps. The reason for this treatment goes back to the statute's origins. The interlocking directorate prohibition was enacted due to concerns that competitors could use boardroom activities to facilitate collusion. In 1914, the same year Section 8 was enacted, Louis Brandeis characterized director interlocks between competitors as "the root of many evils." Louis D. Brandeis, *Other People's Money and How the Bankers Use It*, 51 (1914).

Section 8 is a prophylactic measure meant to "nip in the bud incipient violations of the antitrust laws by removing the opportunity or temptation to such violations through interlocking directorates." *TRW, Inc. v. Fed. Trade Comm'n,* 647 F.2d at 946. In addition to

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2 Sidley represented Blucora, Inc. in its successful defense of the proxy contest launched by Ancora Holdings, Inc.

covering direct interlocks between competitors, it applies in cases where the interlock is at the board level and the competition occurs between the controlled subsidiaries instead of the parent companies. See, e.g., *In re BorgWarner Corp.*, 101 F.T.C. 863, 910 (1983), 102 F.T.C. 1164 (1983), *modified, rev'd sub nom., Borg-Warner Corp. v. FTC,* 746 F.2d 108 (2d Cir. 1984). It applies not only to individuals who sit on multiple boards but also to entities that have representatives on boards of competing companies. So if Entity A has a representative on the board of Company X and a different representative on the board of Company Y—a competitor of X—Section 8 would be violated if the jurisdictional thresholds are met.

Jurisdictional thresholds. Section 8 only prohibits director interlocks between companies that exceed the jurisdictional thresholds, have competitive sales above a *de minimis* level and have business activities with or within the United States. For 2021, the net worth (assets exceeding liabilities) threshold is $37,382,000 and the gross revenue threshold is $3,738,200. Even if the two companies exceed these thresholds, Section 8 would not apply if (1) the competitive sales of either company are less than $3,783,200 (2021 threshold), (2) the competitive sales of either company are less than 2% of that company's total sales or (3) the competitive sales of each company are less than 4% of that company's total sales.

Courts and the agencies have taken a broad view of what constitutes competition for purposes of Section 8.

Competition is defined broadly. Section 8 prohibits interlocks between companies that are "competitors, so that the elimination of competition between them would constitute a violation of the provisions of *any* of the antitrust laws." Clayton § 8, 15 U.S.C. § 19 (a)(1)(B) (emphasis added). Courts construe the statute broadly to prohibit interlocks between "ostensible competitors" on the basis that "the statute reflects a public interest in preventing directors from serving in positions which involve either a potential conflict of interest or a potential frustration of competition." *Protectoseal Co. v. Barancik*, 484 F.2d 585, 589 (7th Cir. 1973) (Stevens, J.). It applies equally to low levels of competition as it does to those affecting larger segments of commerce.

Courts and the agencies have taken a broad view of what constitutes competition for purposes of Section 8. Companies are considered competitors if they (1) are recognized by the industry as competing, (2) serve a similar function and (3) serve a common market. See *TRW, Inc. v. Fed. Trade Comm'n*, 647 F.2d 942, 947 (9th Cir. 1981). Courts and the FTC have found that a board interlock violated Section 8 even where customers may not be aware of the offerings of both parties, only one of the companies is able to meet a customer's requirements and the amount of actual competition between the two parties is *de minimis*. *Id.; see also* 1984 FTC Advisory Opinion re proposed SCM/Bohemia interlock (finding potential interlock despite no known direct competition between the two companies for sales to the same customer and combined market share of less than 1%).

One-year grace period. Any officer or director who was eligible to serve at the time of his or her election or selection to serve in the position has a one-year grace period after an intervening event to resign from that position. Intervening events would include one of the corporations crossing over the net worth threshold, exceeding the *de minimis* competitive overlap thresholds or making an acquisition that results in the two companies becoming competitors. At the moment the intervening event occurs, the director can lawfully serve for one year.

Other antitrust considerations. Even if the interlocking directorate is not prohibited, other antitrust laws may require the officer or director to take steps to recuse himself or herself from participation in certain decisions and not access certain information provided to the board that is directly relevant to the competitive overlap.

- The FTC has applied Section 5 of the FTC Act (which broadly declares "unfair methods of competition…unlawful") to enforce the "spirit and policy" of Section 8 to reach interlocks that Section 8 may not prohibit, such as interlocks between entities that are not corporations.
- Interlocks may be deemed part of an unlawful conspiracy under Section 1 of the Sherman

Act. Accordingly, even where Section 8 of the Clayton Act does not prohibit an interlock—e.g., where a *de minimis* exception is available—appropriate safeguards (e.g., information firewalls or recusals) should be considered as a means of preventing impermissible communications between the firms involved.

Enforcement. Section 8 can be enforced through actions brought by the DOJ or the FTC. Private parties also may sue under Section 8. The principal remedy for a violation is elimination of the interlock and, possibly, prohibitions of future interlocks. Damages are theoretically available to private plaintiffs, but we know of no case where they were awarded.

Section 1 of the Sherman Act increases the risk of liability (including treble damages) to the company if the company receives nonpublic competitively sensitive information about its competitor through the board representation or the board pulls its competitive punches based on the interlock.

Mitigating antitrust risk when Section 8 does not apply. In cases where the interlock falls outside Section 8 coverage, companies would need to resolve the Section 1 and Section 5 issues. Such measures would require that the interlocked director be restricted from receiving competitively sensitive information that she could use in her role as a director on the other board. To the extent there is an overlap, such a protocol often includes the interlocked director's removal and recusal from meetings, decisions and other communications that relate to the competitive overlaps. The protocol also often would restrict the interlocked director from receiving any nonpublic competitively sensitive information about the competitive overlap unless it is in an aggregated form that does not state, identify or describe any competitively sensitive information.