

Client Alert

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Updated Clayton Act Thresholds Should Prompt Investors to Review Interlocking Directorates —Can Bring Antitrust Scrutiny—

Recent antitrust enforcement activity with respect to M&A and Hart-Scott-Rodino highlights the need to remain mindful of other areas under the jurisdiction of the antitrust agencies. One that gets less than its fair share of attention is the Clayton Act Section 8 prohibition on interlocking directorates.

Section 8 of the Clayton Act is a long standing, statutory prohibition on interlocking directorates between competing corporations, with notable carve-outs discussed below, and was amended in 1990 to include officers chosen by the Board of Directors. The prohibitions are designed to prevent the facilitation of anticompetitive coordination and information exchanges through simultaneous officer or board membership between competing corporations. The issue is particularly relevant for sector investment funds that have separate but competing companies in a portfolio under common management.

Under the statute, no person, or representatives of the same person or entity, is permitted to serve simultaneously as a director or officer of competing corporations (with some exceptions for financial institutions) such that the elimination of competition

by agreement between the corporations would constitute a violation of the antitrust laws.¹ The prohibitions of Section 8 are limited to cases in which each of the corporations has capital, surplus, and undivided profits of more than \$26,161,000.² The capital, surplus, and undivided profits language of the statute is typically read as a net equity test.

Because of the minimal impact on competition likely to flow from interlocks where the competitive sales of the corporations are sufficiently small, Section 8 does not apply where the total competitive sales of either corporation are de minimis (representing less than 2 percent of its total sales or less than \$2,616,100)³; or where the competitive sales of each of the corporations represent less than 4 percent of its total sales. Competitive sales are defined in the statute as “the gross revenues for all products and services sold by one corporation in competition with the other” based on gross revenues in the corporation’s last completed fiscal year. The statute permits directors and officers whose appointment was not prohibited to continue to serve for up to one year after the Section 8 thresholds are exceeded (*i.e.*, as a result of an increase in net equity or increased sales).

Fund managers will find themselves facing Clayton Act Section 8 issues when investing in competing corporations in a particular sector and then appointing common board members or officers, or board members or officers that are affiliated with a common investment manager. In such cases, the question of whether Section 8 applies turns on (1) whether the corporations have competitive sales; (2) whether the thresholds are exceeded; and (3) whether the directors are under common control.

The question of whether there are competitive sales turns on product market definition and geographic market definition and is limited to cases where there is

¹ 15 USC §19.

² The dollar figure became effective January 13, 2009 and is adjusted annually based on changes in the Gross National Product.

³ See Note 2 above.

a horizontal market relationship – vertical interlocks are not prohibited. One court framed the question this way: “The presence of actual competitiveness . . . is determined by two tests: (1) Can the two products (the defendant’s and the substitute) be said to compete because they are reasonably interchangeable with respect to the uses to which they can be put? (2) Are the two products actually competitive because there is a high cross-elasticity of demand on the part of customers?”⁴ While there are distinctions to be drawn where the companies serve different customers in different geographic locations, enforcement under Section 8 is typically more rigid and does not permit as close a parsing of the question of whether the companies compete in the same relevant market as would be the case in a typical merger analysis. Whether the thresholds are actually exceeded is a purely mathematical analysis applied once the more complicated question of determining the extent of competitive sales is answered.

The antitrust enforcement agencies have taken the position that separate individual directors or officers representing the same person or entity can trigger a violation of the statute, though no court has found a violation in such a case. The typical successful challenge to a prohibited interlock by the antitrust agencies or a private plaintiff results in a consent decree eliminating the interlock, though damages are available as well.

Director or officer interlocks also may be challenged under Section 1 of the Sherman Act as part of an illegal conspiracy in restraint of trade where the interlock serves as a means for competitors to exchange competitively sensitive information. The FTC has also employed Section 5 of the FTC Act to challenge interlocks that are not strictly prohibited by the limitations of Section 8.

In cases where Section 8 is determined not to be applicable, it may be advisable for the fund manager to advise the portfolio companies of its determination and the facts relied on; of the potential for Section 8’s prohibitions on interlocks to become applicable later; and of the importance of closely monitoring compliance with Section 8 and the antitrust laws generally as a fund portfolio company.

⁴ *American Bakeries Company, v. Gourmet Bakers, Inc.*, 515 F. Supp. 977 (D.C. Md., 1981).

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