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Prohibition on Interlocking Directorates May Prohibit a Firm From Appointing Its Agents to Serve As Directors of Competing Corporations

Section 8 of the Clayton Act ("Section 8") provides that "[n]o person shall, at the same time, serve as a director or officer in any two corporations" that are "competitors." 15 U.S.C. § 19(a)(1). Firms ought to consider Section 8 before placing individuals – even different individuals – on the boards of competing corporations. Whether Section 8 applies to a firm depends on several factors, including (1) whether the competing corporations satisfy statutory threshold requirements, (2) whether those corporations are "competitors," (3) whether the appointed individuals act as agents of the firm, and (4) the ownership interest of the appointing corporation in each of the firms.

Statutory Threshold Requirements

By its own terms, Section 8 does not apply when:

1. Either of the competing corporations is a bank, banking association, or trust company, 15 U.S.C. § 19(a)(1)[1];
2. Either of the competing corporations has less than $24,001,000[2] in aggregate capital, surplus, and undivided profits, *id.*;
3. Either of the competing corporations' "competitive sales" in the preceding fiscal year were—
   (a) Less than $2,400,100, 15 U.S.C. § 19(a)(2)(A), or
   (b) Less than two percent of its total sales, 15 U.S.C. § 19(a)(2)(B); or
4. Each (not either) competing corporation's "competitive sales" in the preceding fiscal year were less than four percent of its total sales, 15 U.S.C. § 19(a)(2)(C).

[1] Such entities are, however, subject to the Depository Institution Management Interlocks Act, 12 U.S.C. §§ 3201-08.

[2] This figure and the $2,400,100 "competitive sales" figure are the current values of thresholds that are adjusted on October 1 of each year in an amount corresponding to the percentage change in GNP. 15 U.S.C. § 19(a)(5).

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"Competitors"

The text of Section 8 provides that corporations are "competitors" if "the elimination of competition by agreement between them would constitute a violation of any of the antitrust laws." 15 U.S.C. § 19(a)(1)(B). This is generally understood to mean that Section 8 applies if the two corporations can violate the law by fixing prices, allocating markets, or otherwise agreeing to restrain trade.

Different Individuals

While Section 8 prohibits a "person" from serving on the boards of competing corporations, it may also prohibit a firm from doing so through the appointment of different agents to serve on the boards of competing corporations.

This issue was considered in *Reading Intern., Inc.* v. *Oaktree Capital Management LLC*, 317 F. Supp.2d 301 (S.D.N.Y. 2003), in which an independent movie theater sued two movie-theater chains and a private equity firm that owned 40% and 17%, respectively, of the chains. The independent theater alleged that the private equity firm violated Section 8 by placing its president on the board of one chain and, at the same time, one of its principals on the board of the other. Defendants moved to dismiss, arguing that Section 8 prohibits only those interlocks in which a single individual serves on two boards. The court disagreed, holding that a Section 8 violation could be proven by showing that the two board members acted as the "deputies" or "instrumentalities" of the private equity firm, such that the firm, in effect, sat on both boards.

Although this issue is not well settled, the holding in *Reading* has some support in other district court opinions and in positions taken by the DOJ and FTC. *See*, *e.g.*, *United States* v. *International Ass'n of Machinists*, 1994 WL 728884, 1994-2 Trade Cas. (CCH) ¶ 70,813 (D.D.C. 1994) (DOJ consent decree requiring union with representatives on two airlines boards to create a firewall between them); *Advisory Opinion Letter to United Auto Workers*, 97 F.T.C. 933 (1981) (FTC generally believes "that a corporation or association may violate Section 8 of the Clayton Act if it has representatives or deputies serving simultaneously on the boards of two competing corporations").

Wholly Owned Subsidiaries

Another issue to consider is whether Section 8 applies when the competing corporations are wholly owned subsidiaries of the same firm. This issue was addressed in *Las Vegas Sun, Inc.* v. *Summa Corp.*, 610 F.2d 614 (9th Cir. 1979), in which defendants were six casinos that Howard Hughes owned or controlled through three corporations. Defendants were accused of violating Section 8 because several individuals simultaneously acted as directors of more than one of Hughes's corporations. The Ninth Circuit, however, held that because the casinos "operated as a single economic entity and not as competitors, the presence of common directors on the boards of the three controlling corporations . . . does not violate section 8 of the Clayton Act." This result is consistent with the Supreme Court's subsequent holding that corporations owned wholly in common constitute a single entity for Sherman Act § 1 purposes, and thus are legally incapable of conspiring among themselves. *Copperweld Corp.* v. *Independence Tube Corp.*, 467 U.S. 752 (1984).

In *Summa*, the competing corporations were wholly-owned subsidiaries. It has not been clearly resolved whether Section 8 applies when the competing corporations are merely majority-owned subsidiaries. While several district courts cases have relied on *Copperweld* to hold that majority-owned subsidiaries are legally incapable of conspiring, those cases did not consider Section 8. *See, e.g.*, *Bell Atl. Bus. Sys. Servs.* v. *Hitachi Data Sys. Corp.*, 849 F. Supp. 702, 706-07 (N.D. Cal. 1994). An exemption for majority-owned subsidiaries would be consistent with the Hart-Scott-Rodino Act, which provides that advance notice of a merger is not required when the acquiring entity already owns 50 percent or more of the acquired entity. 15 U.S.C. § 18a(c)(3).

It is likely, however, that Section 8 does apply when the competing corporations are minority-owned subsidiaries of the same parent. In *Reading*, as noted above, the district court declined to dismiss a Section 8 claim against a private equity firm that owned 40% and 17%, respectively, of the competing corporations to which it allegedly appointed directors. 317 F. Supp.2d at 308.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues discussed in this memorandum may be addressed to either of the following:

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