Federal Trade Commission Makes Inquiries Into Interlocking Boards

May 5, 2009

The Federal Trade Commission (FTC) has begun making inquiries into the fact that certain individuals hold seats on the boards of both Apple and Google, according to an article in today's New York Times.[1] Section 8 of the Clayton Act (Section 8) prohibits an individual from serving as a director or board elected or appointed officer of two or more competing companies, absent certain exceptions detailed below. Section 8 has not been seen as an enforcement priority of the antitrust agencies in recent years, but this FTC inquiry may reflect a shift in priorities brought on by the new administration. In light of this FTC inquiry, we review Section 8 and its exemptions below.

Section 8 is a prophylactic statute prohibiting, in certain circumstances, a person from serving as a director or officer of two or more corporations (an interlock) where the interlocked corporations are competitors. Its intent is to help ensure that a director or officer of one corporation cannot affect the competitive behavior of a competing corporation by serving that corporation in a high-level position in which he or she would be privy to confidential competitive information or could affect competitive decisions.

IN ORDER FOR SECTION 8 TO APPLY, THE FOLLOWING CONDITIONS MUST BE MET[2]

1) There is an interlock between two or more corporations. Section 8 does not apply to interlocks between noncorporate entities or between a corporation and a noncorporate entity. In addition, Section 8 does not apply to interlocks involving banks and other depository institutions and their holding companies;[3]

---

1 Miguel Helft and Brad Stone, *Board Ties At Apple And Google Scrutinized*, N.Y. TIMES, May 5, 2009, at B1.

2 Even where Section 8 does not apply, interlocks can also be investigated under Section 1 of the Sherman Act (based on collusion and related information exchanges) and Section 5 of the FTC Act (covering unfair trade practices).

3 Banking interlocks are covered by the Depository Institution Management Interlocks Act, 12 U.S.C. §§ 3201-08 (2006).

2) For interlocks involving officers, the officer in question must be elected or appointed by the board of directors.

3) Both corporations must be engaged, in whole or in part, in interstate commerce.

4) The two corporations must be considered competitors by virtue of their products and the location of their operations. Section 8 requires a horizontal, competitive relationship between the two companies such that the elimination of competition by agreement between them would constitute a violation of any of the antitrust laws. If the companies have a vertical or supplier relationship, Section 8 does not apply. Factors to consider in determining whether the corporations compete include whether their products are interchangeable, whether the industry and customers recognize the products as competing, whether production techniques are similar, and whether the products have distinctive customers. The statute applies only to actual competition; potential competition is not enough.

5) Each of the corporations concerned must have an aggregate net worth of more than $26,161,000 (threshold adjusted annually). Net worth is measured as the total of capital, surplus, and undivided profits. In calculating the aggregate net worth, only the interlocking corporate entities themselves are considered; the net worth of parents, subsidiaries, and other affiliates are not included.

6) Finally, the interlock need not involve the same individual serving as the director or officer of two competing companies in order for a Section 8 violation to occur. In *Reading Int'l Inc. v. Oaktree Mgmt. LLC*, 317 F. Supp. 2d 301, 326 (S.D.N.Y. 2003), the court recognized plaintiffs' theory that "when a parent company designates different persons to sit on the boards of competing subsidiaries, these persons are treated as 'deputies' for § 8 interlock purposes" (internal quotations and citation omitted). Accordingly, under *Oaktree* there can be a Section 8 violation where the parent corporation designates different persons to sit on the boards of competing companies *if* the relevant individuals' service on the board is not in their individual capacity but rather "as the deputies of" the parent corporation "such that it can legitimately be said that it is" the parent company as an entity and not the individual that serves as a director. *Id.*

"SAFE HARBORS" MAY ALSO EXEMPT THE INTERLOCK FROM SECTION 8 SCRUTINY

Section 8(a)(2) safe harbors for *de minimis* interlocks apply when any one of the below conditions is met. If one of these conditions is met, no violation of Section 8 has occurred:

1) "Competitive sales" (the gross revenues for all products and services sold by one corporation in competition with the other) of either corporation are less than $2,616,100 (threshold adjusted annually);

2) "Competitive sales" of either corporation are less than 2 percent of its total sales of all products and services; or

3) "Competitive sales" of each corporation are less than 4 percent of its total sales.

Note that if an interlocked director is safely serving as a dual director/officer because these (or the above net worth) thresholds are not exceeded at the time of the interlock, but the net worth or competitive sales of a corporation rise above one of the thresholds during that director's otherwise lawful service, the dual director/officer has one year to resign from one of the positions.

ENFORCEMENT REMEDIES UNDER SECTION 8

The consequences of violating Section 8 have traditionally been relatively mild, at least as compared to other violations of the antitrust laws. Unlike the price-fixing statutes, Section 8 is not a penal statute, and persons who serve interlocking boards and their corporations are not subject to criminal penalties. The most common remedy is for either the Justice Department or the FTC to bring an enforcement action to eliminate the unlawful interlock and, typically, to enjoin future interlocks. The companies can typically settle these suits by simply removing the interlocked director from one of the posts and by signing onto a consent agreement agreeing to institute an annual monitoring program for a number of years (usually five) designed to detect or prevent other unlawful interlocks.

This memorandum is for general information purposes and should not be regarded as legal advice. Please contact your relationship partner if we can be of assistance regarding these important developments. The names and office locations of all of our partners, as well as our recent memoranda, can be obtained from our website, www.simpsonthacher.com.

UNITED STATES

New York
425 Lexington Avenue
New York, NY 10017
212-455-2000

Los Angeles
1999 Avenue of the Stars
Los Angeles, CA 90067
310-407-7500

Palo Alto
2550 Hanover Street
Palo Alto, CA 94304
650-251-5000

Washington, D.C.
601 Pennsylvania Avenue, N.W.
North Building
Washington, D.C. 20004
202-220-7700

EUROPE

London
Citypoint
One Ropemaker Street
London EC2Y 9HU England
+44-20-7275-6500

ASIA

Beijing
3119 China World Tower One
1 Jianguomenwai Avenue
Beijing 100004, China
+86-10-5965-2999

Hong Kong
ICBC Tower
3 Garden Road
Hong Kong
+852-2514-7600

Tokyo
Ark Mori Building
12-32, Akasaka 1-Chome
Minato-Ku, Tokyo 107-6037, Japan
+81-3-5562-6200

Celebrating 125 YEARS 1884-2009