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FTC challenges director interlock involving non-corporate entity

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Last week, the FTC settled a director interlock lawsuit with EQT/Quantum, which is notable for three key reasons: (1) it confirms the FTC's focus on enforcing the interlocking directorate prohibition; (2) it involves an enforcement against a *non-corporate* interlock; and (3) it shows a willingness to use a merger review to unwind preexisting joint ventures. In advance of potential merger reviews, companies should proactively evaluate possible interlocks and existing bi-lateral relationships.

On August 16, 2023, the U.S. Federal Trade Commission (FTC) announced that it had simultaneously sued and approved a settlement (a consent order) related to the proposed acquisition of EQT Corporation by funds managed by Quantum Energy Partners (Quantum). The key terms of the proposed order include requiring Quantum to forego its right to a seat on EQT's Board and unwinding a pre-existing joint venture, The Mineral Company, between EQT and Quantum. Below are three key takeaways from the announcement:

Antitrust compliance efforts should include regular reviews for potential interlocking directorates, including for investment entities.

- The FTC's latest consent decree is consistent with a renewed focus on enforcing the prohibition on interlocking directorates under Section 8 of the Clayton Act, which prohibits one person from serving as an officer or director of two competing companies.
- Up until last week, the Antitrust Division of the U.S. Department of Justice (DOJ) has led Section 8 enforcement efforts, including a series of challenges since October 2022.[1] This latest consent order signals the FTC's focus in this area—the first case by the agency in this area in 40 years.
- Companies, particularly investment funds, should evaluate possible interlocking directors between non-controlled[2] subsidiaries, including whether a prohibit interlock would arise from a proposed transaction. Failure to do so may lead to prolonged investigations and enforcement actions.

The use of non-corporate structures may not insulate entities from FTC (and DOJ) scrutiny for interlocking directorates.

- By its terms, Clayton Act Section 8 applies to "corporations (other than banks, banking associations, and trust companies)" without reference to LLCs or partnerships or other forms of organization. Here, Quantum is organized as a limited partnership and the two acquisition vehicles owned by Quantum were structured as a limited partnership and an LLC. As such, we believe it is the first challenge by either the FTC or the DOJ of an interlock involving an LLC or partnership.
- FTC Chair Lina Khan, joined by the two other Democratic commissioners, issued a statement that "[the consent order] makes clear that Section 8 applies to businesses even if they are structured as limited partnerships or limited liability corporations." This follows comments from the former head of the Antitrust Division, Makam Delrahim, in 2019 that the DOJ may also be considering enforcing Section 8 against non-corporate entities.

- This is a controversial position to take. The Supreme Court has previously held that Section 8 does not apply to banks because they are not "corporations" and commentators have suggested that the same reasoning should exclude partnerships and LLCs from coverage under Section 8.
- The FTC's complaint also alleged that the interlock was independently an "unfair method of competition" that violated the competition safeguards in Section 5 of the FTC Act. This is consistent with the FTC November 2022 policy statement, which suggested that Section 5 had a broad scope and covers "interlocking directors and officers of competing firms not covered by the literal language of the Clayton Act."[3]
- As a result, companies utilizing non-corporate structures should consider possible non-corporate interlocks, including those arising from a potential transaction. The consent decree is not a legal precedent binding upon the courts, however, and it remains to be seen whether the FTC's position that Section 8 applies to partnerships and LLCs will be accepted.

Merging parties should anticipate that the FTC may investigate and challenge "unfair methods of competition" under Section 5 of the FTC Act—including those that are unrelated to the merger.

- In the complaint, the FTC alleged that The Mineral Company—a joint venture formed by the parties well before the transaction under review—violated Section 5 of the FTC Act because the venture allowed for the exchange of competitively sensitive, non-public information.[4] As part of the consent order, the FTC required the parties to unwind The Mineral Company, including any non-compete provisions.
- Accordingly, merging parties should consider existing relationships as part of regulatory reviews and anticipate potential scrutiny of those arrangements when estimating timing for regulatory compliance.

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

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[1] Press Release, U.S. Dep't of Just., Two Pinterest Directors Resign from Nextdoor Board of Directors in Response to Justice Department's Ongoing Enforcement Efforts Against Interlocking Directorates (Aug. 16, 2023), https://www.justice.gov/opa/pr/two-pinterest-directors-resign-nextdoor-board-directors-response-justice-departments-ongoing; Press Release, U.S. Dep't of Just., Justice Department's Ongoing Section 8 Enforcement Prevents More Potentially Illegal Interlocking Directorates (Mar. 9, 2023) https://www.justice.gov/opa/pr/justice-department-s-ongoing-section-8-enforcement-prevents-more-potentially-illegal; Press Release, U.S. Dep't of Just., Directors Resign from the Boards of Five Companies in Response to Justice Department Concerns about Potentially Illegal Interlocking Directorates (Oct. 19, 2022), https://www.justice.gov/opa/pr/directors-resign-boards-five-companies-response-justice-department-concerns-about-potentially; Press Release, U.S. Dep't of Just., Endeavor Executives Resign from Live Nation Board of Directors after Justice Department Expresses Antitrust Concerns (Jun 21, 2021), https://www.justice.gov/opa/pr/endeavor-executives-resign-live-nation-board-directors-after-justice-department-expresses.

[2] If two related parties have an "unity of purpose" under *Copperweld* (which typically requires, at minimum, a 50% or greater interest), courts have found them not to be competitors for purposes of Clayton Act Section 8.

[3] Fed. Trade Comm'n, Policy Statement Regarding the Scope of Unfair Methods of Competition Under Section 5 of the Federal Trade Commission Act, Comm'n File No. P221202 at 9 (Nov. 10, 2022), https://www.ftc.gov/system/files/ftc_gov/pdf/P221202Section5PolicyStatement.pdf.

[4] This follows a policy statement by the FTC in November 2022 that adopted an expansive view of FTC authority, without specific enforcement principles or guidance. For more information, see Davis Polk, Client Update, FTC interprets "unfair competition" broadly in new Section 5 policy statement (Nov. 15, 2022), https://www.davispolk.com/insights/client-update/ftc-interprets-unfair-competition-broadly-new-section-5-policy-statement.