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What to Know About the New 'Overlapping Directorship' Antitrust Development

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January 9, 2025

The board's governance and nominating committee will benefit from the general counsel's briefing on the latest development affecting antitrust enforcement of interlocking directorships.

On Dec. 18, the Justice Department ("DOJ") announced that two directors of Epic Games Inc. ("Epic"), who had been appointed by Tencent Holdings Ltd. ("Tencent"), resigned from the Epic board after the Antitrust Division "expressed concerns" that their positions on the Epic board and the board of a Tencent affiliate violated Section 8 of the Clayton Act.

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The DOJ announcement describes Tencent as "one of the largest multimedia and video game companies in the world."Tencent is a minority shareholder in Epic and has equity investments in other video game and media companies, including Riot Games Inc. Epic is a privately held video game and software developer and publisher. Riot is an American video game developer, publisher, and esports tournament organizer.

DOJ's position is that interlocking directorships arose from the fact that Tencent also is the parent company of Riot, a gaming competitor to Epic.

Section 8 (which Congress made a *per se* violation of the antitrust laws), prohibits directors and officers from serving simultaneously on the boards of competing corporations, subject to limited exceptions. Notably, Section 8 is a strict liability statute; i.e., once prohibited interlocks are established these violations are regarded as per se unlawful and are not dependent on evidence of actual harm to competition. The DOJ announcement makes clear that no company or individual has admitted to liability in connection with this investigation.

In response to DOJ's concerns, Tencent has amended its shareholder agreement with Epic to relinquish its unilateral right to appoint directors or observers to the Epic board in the future.

From a corporate governance perspective, the significance of this development is two-fold:

First, it confirms a continued focus of the federal antitrust enforcement agencies on unwinding or preventing interlocking directorships amongst competitors.

Second, it suggests that the board nominating committee will want to apply an extra level of due diligence when evaluating potential nominees. To avoid interlocking directorships concerns, the committee should confirm that (i) nominees do not hold board positions with a direct competitor; and (ii) similarly, their organization does not have any affiliates that compete with the other organization in which one or more of their directors are being considered for board positions. In other words, nominating committees will want to screen for indirect interlocks as well as direct ones.

This diligence will be important in the committee's initial evaluation of potential director candidates, and of the questionnaire and related information candidates are required to provide to the committee. The diligence could also extend to periodic evaluation of the outside board relationships of current boardmembers (including executives serving ex-officio). Note that in the Tencent situation, DOJ's scrutiny extended to board observers as well as directors.

This diligence is also important when an organization's leadership is considering interlocking directorships as part of change of control transactions or collaborative transactions that offer less than full change of control. The interlocking directorship prohibition isn't always on the "front burner" for the "dealmakers." Efficient regulatory planning for such transactions would thus benefit from close consideration of the competitive relationship of the parties for purposes of antitrust compliance.

The risk of creating problematic interlocking directorship arrangements concern may increase when executive leadership makes their own determination of whether the proposed interlock involves (directly or indirectly) an actual competitor, without consulting the CLO. It's easy to understand, given the natural inclination of executives or board committees with strategic planning experience to rely on their own evaluation of the competitive market.

While heightened enforcement of Section 8 has been a priority of the Biden DOJ, it has also been a subject of enforcement by the FTC. The FTC can use its FTC Act Section 5 authority to challenge interlocks as "unfair methods of competition" and has challenged interlocks that do not violate the text of Section 8 by involving only corporations. Instead, the FTC has challenged interlocks involving limited liability companies, for example, as violating Section 5. That's an important consideration for governance committees and deal planners.

It is uncertain whether under the Trump administration the DOJ and FTC will continue their respective vigorous enforcement of interlocking directorship prohibitions. That said, the States and private plaintiffs can also challenge violations of Section 8. Governance and nominating committees are thus encouraged to be particularly sensitive to antitrust considerations when selecting board candidates--even if it's not always intuitive to consider regulatory risks when formulating strategy. Participation of the general counsel and chief compliance officer can help reduce potential risk.

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