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Joseph Larson & Nathaniel Asker
Wachtell, Lipton, Rosen & Katz

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Charming Shoppes and the Issue of Standing under Section 8

Joseph Larson & Nathaniel Asker*

A recent case in the Eastern District of Pennsylvania, *Charming Shoppes Inc.* v. *Crescendo Partners II, L.P.*,[1] raises an interesting standing issue that raiders or activists in proxy contests could use to eliminate Clayton Act §8 (prohibits persons from being officers and directors of competing corporations) as a potential defense for target companies. Specifically, *Charming Shoppes* held that a company subject to a proxy contest lacked standing to enjoin an activist investor's proposed alternate slate of directors from running for election because the company could not show antitrust injury arising from the alleged violation of Section 8 of the Clayton Act. In prior cases where target companies raised Section 8 issues with respect to a raider's proposed slate, antitrust injury has been either assumed or simply not addressed.[2] The issue of antitrust injury in Section 8 warrants deeper judicial review from both a technical legal as well as a policy perspective because there are strong arguments on both sides of the issue.

On the one hand, there are strong legal arguments that a showing of antitrust injury is required for any action brought under the antitrust laws. In *Atlantic Richfield*, the Supreme Court found that proof of a *per se* violation of Section 1 alone did not satisfy a

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*Joseph Larson is a partner at Wachtell, Lipton, Rosen & Katz. Nathaniel Asker is an associate at Wachtell, Lipton, Rosen & Katz.

[1] 557 F. Supp. 2d 621, 629-30 (E.D. Pa. 2008).

[2] *See, e.g.*, Square D Company v. Schneider S.A., 760 F. Supp. 362, 366 (S.D.N.Y. 1991) and Reading International, Inc. v. Oaktree Capital Management LLC, 317 F. Supp. 2d 301 (S.D.N.Y. 2003).

plaintiff's burden to show antitrust injury in order to recover damages. The court stated that "[t]he *per se* rule is a method of determining whether § 1 of the Sherman Act has been violated, but it does not indicate whether a private plaintiff has suffered antitrust injury and thus whether he may recover damages under § 4 of the Clayton Act."[3] The limitations on standing have not been limited to damages actions brought under Section 4 but have been extended to requests for injunctive relief under § 16 of the Clayton Act. For example, a number of circuit court cases have held that targets of hostile tender offers lacked standing to challenge the pending offer under §7 of the Clayton Act.[4] The rationale underlying these and other cases in which plaintiffs have been denied standing is that the plaintiffs stood to gain from any alleged violation of the antitrust laws—either the co-conspirators or the target in a hostile offer would benefit from the higher prices that the defendants would impose on the market if there was, in fact, a violation of the antitrust laws.

As a policy matter, such a limitation on standing is crucial in damages actions because it limits recovery, even for *per se* violations like price fixing, to only those who have been harmed. In actions seeking injunctive relief, the concern is that the plaintiff is trying to use the antitrust laws to achieve a different purpose (*e.g.*, management of a target seeking to entrench itself). In both scenarios, the assumption is that there are plenty of other potential plaintiffs, including customers and government agencies, that would

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[3] Atlantic Richfield Co. v. USA Petroleum Co., 495 U.S. 328, 341-42 (1990).

[4] *See, e.g.*, A.D.M. Corp. v. Sigma Instruments, Inc., 628 F.2d 753 (1st Cir. 1980); Burlington Industries, Inc. v. Edelman, 666 F. Supp. 799 (M.D.N.C.), *aff'd mem*., Fed. Sec. L. Rep. (CCH) ¶93,339 (4th Cir. 1987); and Anago, Inc. v. Tecnol Medical Products, Inc., 976 F.2d 248 (5th Cir. 1992), *cert. dismissed* 510 U.S. 985 (1993); *but see* Consolidated Gold Fields PLC v. Minorco, S.A., 871 F.2d 252 (2d Cir. 1989), *cert. dismissed* 492 U.S. 939 (1989).

seek to prosecute any antitrust violations.

On the other hand, there are good legal arguments that standing under Section 8 should be broadly construed because courts have long recognized Section 8 as a prophylactic statute intended to prevent potential antitrust violations before they can occur.[5] Section 8 prohibits an individual from serving as director or officer of two or more competing corporations if the revenues of the corporations fall outside certain statutorily-prescribed safe harbors.[6] Section 8 simply requires the existence of a horizontal market relationship between the companies involved in the interlock; there is no requirement that an anticompetitive effect be proven or even assumed. The concept of an "injury" requirement seems out of place for a prophylactic statute.

In addition, plaintiffs suing for a potential violation of Section 8 are seeking injunctive rather than monetary relief. The Supreme Court has distinguished a plaintiff's burden to show standing based on the type of remedy sought under the Clayton Act. This distinction arises from the respective remedy provisions of the statute itself. Section 4 of the Clayton Act, which provides for money damages, requires that a plaintiff show actual injury to its business or property by reason of conduct forbidden under the antitrust laws.[7] In contrast, Section 16 requires no showing of actual loss by the plaintiff as it allows

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[5] Square D Company v. Schneider S.A., 760 F. Supp. 362, 366 (S.D.N.Y. 1991), citing SCM Corp. v. Federal Trade Comm'n, 565 F.2d 807, 811 (2d Cir. 1977). *See also* United Auto Workers, 97 F.T.C. 933, 935 (1981).

[6] 15 U.S.C. § 19. These safe harbors are adjusted annually. Currently, simultaneous service as a director or officer of two competing corporations is not prohibited if the competitive sales of either corporation are less than $2,531,900 or either company has combined capital, surplus, and undivided profits of less than $25,319,000. *See* 73 Fed. Reg. 5191 (Jan. 29, 2008). Certain other exceptions may also apply. For additional information regarding Section 8, see ABA SECTION OF ANTITRUST LAW, ANTITRUST LAW DEVELOPMENTS 425-31 (6th ed. 2007).

[7] 15 U.S.C. § 15(a).

parties to seek injunctive relief against *threatened* loss or damage.[8] Noting the more lenient standing requirements for injunctive relief, the Supreme Court explained that "§ 4 requires a plaintiff to show actual injury, but § 16 requires a showing only of 'threatened' loss or damage; similarly § 4 requires a showing of injury to 'business or property', while § 16 contains no such limitation."[9]

The policy reasons for allowing standing to targets under Section 8 are especially strong. Unlike Section 1, Section 2, and Section 7 cases, which all promise private plaintiffs a realistic prospect of treble damages plus attorney's fees, damages for a Section 8 violation, while theoretically possible, have never been awarded to the best of our knowledge. Thus, the private antitrust bar, which the U.S. antitrust laws actively encourage to fill in the gaps in antitrust enforcement at the government level because of limited resources, generally has limited interest in Section 8 cases. In addition, while the Department of Justice ("DOJ") and Federal Trade Commission ("FTC") bring periodic Section 8 challenges, the agencies devote more resources to more hardcore antitrust violations under the substantive antitrust laws. It also takes time for the federal agencies to investigate, build, and bring a case—that is if the agencies don't determine for resource allocation issues to exercise their prosecutorial discretion and let potential violations of Section 8 go unchallenged. While the managements of target companies in proxy contests are likely attempting to maintain their positions, there are other reasons that management would not want to have their company put in potential violation of Section 8. Under the strict disclosure rules of the Sarbanes-Oxley Act, the target company could well be forced

[8] 15 U.S.C. § 26 (emphasis added).

[9] Cargill, Inc. v. Monfort of Colorado, Inc., 479 U.S. 104, 111 (1986) (footnotes and citations omitted).

to disclose in its subsequent SEC filings that it is in potential violation of the federal antitrust laws by virtue of having a director that also sits on a competitor's board. Under these circumstances, it would make sense to empower those with the strongest incentive (*i.e.*, target management) to enforce the prophylactic Section 8 statute.

SUMMARY OF THREE SECTION 8 CASES

In *Reading International, Inc.* v. *Oaktree Capital Management LLC*, an independent movie theatre sought *inter alia* to enjoin an alleged preexisting interlock within the boards of two national movie theatre chains.[10] In moving to dismiss the Section 8 claim, Oaktree argued in part that the plaintiffs failed to adequately allege antitrust injury caused by the interlock. The court rejected the argument, finding that the plaintiffs' allegation that the interlock played a key role in the coordination of the two theatre chains, and that such coordination harmed both the plaintiffs' ability to compete and movie-viewing consumers, was sufficient.[11] The plaintiffs also argued that they need not allege injury at all in order to seek injunctive relief under Section 8, but the court declined to reach this issue as the plaintiffs had adequately alleged antitrust injury.[12]

Square D Co. v. *Schneider S.A.* held that a potentially interlocked corporation could proceed with its motion to enjoin the election of a rival nominee to the company's board under Section 8.[13] Square D, a target of a hostile takeover attempt, sought injunctive relief against the potential acquirer under Sections 7 and 8 of the Clayton Act and Section 1 of the Sherman Act. Schneider moved to dismiss, arguing in part that its

[10] 317 F. Supp. 2d 301 (S.D.N.Y. 2003).

[11] *Id.* at 332.

[12] *Id.*

[13] 760 F. Supp. 362, 368 (S.D.N.Y. 1991).

nominees would not violate Section 8 because the nominees were not officers or directors within the meaning of Section 8. The court rejected the argument, finding that a cause of action under Section 8 is stated where a company attempts to place on the board of a competitor individuals who are agents of the company.[14] While Schneider argued that *Consolidated Gold Fields,* [15] the Second Circuit decision finding that a target company had standing to seek injunctive relief under Section 7 because a target can allege antitrust injury, was wrongly decided, the defendant did not argue, nor did the court find, that a target company lacks standing under Section 8.

Charming Shoppes involved a specialty apparel retailer with a leading share of the women's plus-size apparel business. Charming Shoppes was subject to a proxy contest for nomination of three of eight members of the company's board of directors. Crescendo, an investment firm, led a group of activist investors that nominated an alternate slate of directors, including a nominee currently sitting on the board of a maternity clothing retailer, to challenge reelection of the incumbent directors. Charming Shoppes sought an injunction alleging violations of the securities laws and of Section 8. The court denied Charming Shoppes' motion for preliminary injunction.

While the bulk of the opinion focused on the securities law claims, the court also denied the Section 8 claim because it found the plaintiff had failed to allege antitrust injury. The court undertook a standard antitrust injury analysis, citing to cases analyzing injury under the Sherman Act and Section 7 of the Clayton Act. Charming Shoppes

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[14] *Id.* at 367.

[15] *See* Consolidated Gold Fields PLC v. Minorco, S.A., 871 F.2d 252 (2d Cir. 1989), *cert. dismissed* 492 U.S. 939 (1989).

argued that it faced potential antitrust injury from disclosure of trade secrets to a competitor facilitated by the interlock. The court rejected this argument, stating that while this disclosure may indeed harm the company, "the revealing of trade secrets does not hinder competition in the retail clothing market."[16] The court then conflated its inquiry by switching its analysis from competition in retail clothing to competition within the proxy contest itself. Citing to the familiar axiom that antitrust laws protect competition, not competitors,[17] the court stated that "Section 8 was not created as vehicle for courts to sit in judgment of competitors in a proxy contest."[18]

[16]557 F. Supp. 2d 621, 629-30.

[17]*See, e.g.*, Cargill, Inc. v. Monfort of Colorado, Inc., 479 U.S. 104 (1986).

[18]557 F. Supp. 2d 621, 630.