

Assessing Overlapping Boards After DOJ Crackdown

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Editor's note: Authored by Howard Morse, Parker Erkmann and Nicollette R. Kirby, this article was [originally published in Law360](#).

Over the past year, the [U.S. Department of Justice](#) has garnered headlines by issuing press releases announcing that directors have stepped down from 10 company boards, in response to DOJ concerns that their roles violated the Clayton Act's Section 8 prohibitions on interlocking directorates.

In October 2022, the DOJ announced the [resignation of directors](#) from the boards of five companies.[1] Another round of resignations [was announced](#) in March 2023: Five directors resigned from four corporate boards, and one company declined to exercise board appointment rights.[2]

Antitrust Division Assistant Attorney General Jonathan Kanter has argued that cracking down on interlocking boards is "probably the most effective way of deconcentrating the United States economy today." [3]

At the [American Bar Association](#) 2023 Antitrust Spring Meeting, [Kanter said](#) that the DOJ now has a "vibrant Section 8 enforcement" program with nearly 20 open investigations and "many additional opportunities out there for investigation and enforcement." [4]

This [scrutiny](#) should cause corporations to look at the makeup of their boards and investors to look at the boards on which they sit, and to adopt policies to minimize the risk of the government finding an antitrust violation.

Questions have been raised following the DOJ announcements as to when Section 8 applies: When will companies be considered competitors? Does the statute reach potential competitors? Does it reach different representatives of investors on the boards of competitors? How can companies avoid charges that directors have fixed prices or divided markets?

After discussing the law underlying DOJ's recent actions, we explore these questions.

The DOJ has issued press releases, but hasn't taken enforcement action.

It is notable that these DOJ actions have led to directors resigning, with the DOJ issuing press releases naming the companies but not identifying the individual directors by name, and without lawsuits or civil penalties.

While Section 8 does not provide the government with authority to seek monetary relief, the DOJ could sue to obtain injunctive relief to prevent future violations, and the Federal Trade Commission could obtain cease-and-desist orders in administrative litigation. Both agencies have done so at times in the past. A violation of such orders could result in contempt or civil penalties, as well as costs and attorney fees.

The DOJ, moreover, has not obtained judicial decisions. To the extent DOJ is seeking to expand the law, the precedential value of its actions is limited.

Clayton Act Section 8 is a strict liability statute.

Section 8 is a strict liability federal antitrust law that prohibits a person from concurrently serving as an officer or director of competing corporations —i.e., an interlocking directorate — unless de minimis exemptions apply.

Companies cannot defend an action on the basis that there has been no adverse effect on competition. Rather, as the [U.S. District Court for the Southern District of New York](#) noted its 2003 Reading International Inc. v. [Oaktree Capital Management LLC](#) decision, quoting precedent, Section 8 seeks to prevent "incipient violations of the antitrust laws by removing the opportunity or temptation to such violations through interlocking directorates."^[5]

The proscriptions of Section 8 are largely dictated by the language of the statute — in contrast to the flexible language of Sections 1 and 2 of the Sherman Act, which prohibit agreements in restraint of trade and monopolization, that rely on common law interpretation.

The statute prohibits all interlocks between "corporations" engaged in commerce that are, "by virtue of their business and location of operation, competitors, so that the elimination of competition ... between them would constitute a violation of any of the antitrust laws."

The statute does require that the corporations have "capital, surplus, and undivided profits" of more than \$45,257,000, adjusted annually for changes in gross national product. And the law exempts interlocks when the "competitive sales" of corporations do not meet certain thresholds.

"Competitive sales" is defined in the statute to mean the gross revenue for all the products and services "sold by one corporation in competition with the other," in each corporation's last completed fiscal year. Thus, the statute does not prohibit an interlock if:

- Either corporation's competitive sales are less than \$4,525,700, adjusted annually;
- Either corporation's competitive sales are less than 2% of the company's total sales; or
- Each corporation's competitive sales are less than 4% of its total sales.

Importantly, these de minimis exceptions mean that Section 8 will not apply to startup companies that do not yet earn any revenue.

Moreover, the statute provides for a one-year grace period from the date of an intervening event — e.g., sales in the last fiscal year exceeding the threshold, or a transaction that results in competitive sales over the threshold — that makes continued participation on the board of both firms unlawful.

All of this, and the DOJ's recent actions, raise questions about the scope of Section 8, including when companies will be considered competitors, whether the statute reaches potential competitors, and whether it reaches different representatives of investors on the boards of competing corporations.

What is a competitor under Section 8?

What constitutes a competitor under Section 8 is fact-specific, and the government and the courts look at a variety of factors.

Horizontal Relationship

Courts interpreting Section 8 have generally required an interlock to involve two corporations that are in a horizontal market relationship.

Involvement in different aspects of the same industry has not been sufficient to establish the competitive relationship for a Section 8 interlock due to the absence of competitive sales.

Strict Application to Corporations

By its terms, Section 8 prohibits interlocks involving corporations. The application of Section 8 to limited liability companies has not been addressed by the courts, and the antitrust agencies have not taken an explicit position on the issue.

However, even if an interlock involving an LLC may be permissible under Section 8, companies should consider whether such a relationship could lead to allegations of a conspiracy under Section 1 of the Sherman Act before allowing one.

Assessing Competitive Sales

In assessing whether there are competitive sales, courts have also looked to the market definition analyses used in claims brought under the Sherman and Clayton Acts to see, in the words of the U.S. District Court for the Northern District of California in its 1976 U.S. v. Crocker National Corp. decision, if companies have "common sales in the same product or geographic market."

Thus, courts have looked to whether two products compete because they perform reasonably interchangeable functions, and whether customer demand is highly elastic between the two products.[6]

Other courts, however, have said that relying on interchangeability of use and cross-elasticity of demand may be too restrictive, especially "[i]n a developing industry in which product variation is just beginning and customer needs are not yet standardized," as the U.S. Court of Appeals for the Ninth Circuit articulated in its 1981 TRW Inc. v. [FTC](#) decision.[7]

Thus, courts also have relied on more subjective evidence that companies sought to sell similar products to the same prospective customers.[8]

Descriptions of a Company as a Competitor

Notably, in the DOJ's recent announcements of resignations, several of the matters involved public corporations that had directors identified in their proxies as serving on the boards of companies that were identified as "competitors" in the companies' other [U.S. Securities and Exchange Commission](#) filings.

Other investigations appear to have stemmed from merger investigations, where one corporation potentially identified the other corporation as a competitor in internal documents submitted with a merger filing.

These actions suggest companies should pay close attention to these issues before making SEC and HSR filings.

Section 8 does not apply to potential competitors.

As noted above, companies' competitive sales must exceed the de minimis threshold for a Section 8 violation.

Thus, it is not surprising that Section 8 has not been applied to potential competitors. Indeed, a dated but recently cited FTC report

states that Section 8 "leaves unchallenged interlocking directorates between corporations, both large and small, that have not been competitors in the past but might become so in the future."^[9]

Courts have followed this guidance, including the Southern District of New York in its 1966 *Paramount Pictures Corp. v. Baldwin-Montrose Chemical Co.* decision, reasoning that a corporation's "plans or intentions to engage in the production of" the relevant product did not "make it a competitor ... within the meaning of Section 8," and therefore Section 8 was not "violated by [the director's] membership on the boards of both companies."^[10]

This should provide some comfort to companies before they have competitive sales, but companies should still be alert to avoiding agreements not to compete or to divide markets through board members.

The scope of the DOJ's representation theory remains uncertain.

The DOJ's press releases note that directors resigned where two different individuals associated with the same venture capital or private equity firm served on the boards of competing corporations. In announcing the resignations, DOJ referred to the board members as "representatives" of the investment firm.

The legal boundaries of this theory of Section 8 liability are not well developed.

The statute defines a "person" to include a corporation, but it can still be argued that only an individual can "serve" as a director.

While it can be said that no court has yet found a violation of Section 8 based on the representative theory, the Southern District of New York in *Reading International* denied a motion to dismiss a case asserting a deputization theory.

The court adopted a strict standard, holding that a plaintiff must demonstrate that the directors were not serving in their "individual capacities, but as ... puppets or instrumentalities of the corporation's will."^[11]

Under that reasoning, if a director performs their duties independently, it will be difficult to conclude that the director is serving as an instrumentality of a particular investor.

The representation theory may be even more difficult to apply if a director sits on the board of a public company and has been elected by its public shareholders.

Since the DOJ's press releases identify board members merely as representatives of the investment firm, it is difficult to discern whether the DOJ is applying the rigorous standard for deputization discussed in *Oaktree Capital*, or a lower standard, where a board member's affiliation with an investment firm is enough to establish an interlock.

Indeed, adopting policies or procedures limiting the exchange of confidential information between board members affiliated with the same investment firm would presumably bolster the argument that Section 8 has not been violated.

Section 8 enforcement will continue.

The DOJ has said that Section 8 investigations are ongoing.

These investigations may lead to additional scrutiny. If a Section 8 investigation uncovers evidence of price-fixing or market allocation facilitated through the unlawful interlock, it is likely that the DOJ would take enforcement action under Section 1 of the Sherman Act — leading to potential civil and even criminal actions.

Companies should be aware that Section 8 has also captured the attention of members of Congress, who have [encouraged](#) the DOJ and the FTC to investigate interlocking boards in the life sciences industry. However, the de minimis exceptions would prevent application of Section 8 to companies in the development stage without sales.

To minimize the risk of a Section 8 enforcement action and the potential for further antitrust scrutiny, companies should conduct regular assessments of the business relationships of their board members and consider antitrust policies or guidelines and training to prevent anticompetitive coordination at the board level.

For example, companies might ask each board member and officer on an annual basis to identify other companies for which they serve as an officer or director, and review such lists for competitors.

For board members affiliated with private equity, venture capital or other investment firms, identification of competitors in which others affiliated with the same firm hold board seats might also be considered. Companies should then consider if the de minimis thresholds apply. In addition, companies may want to provide guidance to prevent unlawful coordination through such board positions.

[1] DOJ, Directors Resign from the Board 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>.

[2] DOJ, 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>.

[3] Michael Acton, US DOJ crackdown on interlocking boards 'probably most effective way' of deconcentrating economy, Kanter says, <https://content.mlex.com/#/content/1460974> (Mar. 31, 2023).

[4] *Id.*

[5] [Reading Int'l Inc. v. Oaktree Cap. Mgmt. LLC](#), 317 F. Supp. 2d 301, 326 (S.D.N.Y. 2003) (quoting [United States v. Sears, Roebuck & Co.](#), 111 F. Supp 614, 616 (S.D.N.Y. 1953).).

[6] See [United States v. Crocker National Corporation](#), 422 F. Supp. 686 (N.D. Cal. 1976), rev'd on other grounds, 656 F.2d 428 (9th Cir. 1981), rev'd sub nom. Bankamerica Corp. v. United States, 462 U.S. 122 (1983) (upholding district court's holding that Section 8 did not prohibit interlocks between a bank and an insurance company).

[7] [TRW Inc. v. Federal Trade Commission](#), 647 F.2d 942, 948 (9th Cir. 1981).

[8] *Id.*

[9] Report of the Federal Trade Commission on Interlocking Directorates (1951).

[10] [Paramount Pictures Corp. v. Baldwin-Montrose Chemical Co.](#), 1966 U.S. Dist. LEXIS 10596, *26 (S.D.N.Y. January 24, 1966).

[11] [Reading International Inc.](#), 317 F. Supp. 2d at 332.

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