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DOJ Focusing Antitrust Scrutiny on the Boardroom Is Your Board Ready

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In April 2022, Assistant Attorney General Jonathan Kanter, head of the US Department of Justice's Antitrust Division, fired a warning shot to companies: "For too long, our Section 8 enforcement has essentially been limited to our merger review process. We are ramping up efforts to identify violations across the broader economy, and we will not hesitate to bring Section 8 cases to break up interlocking directorates."

In September 2022, the Antitrust Division issued a spate of letters to public companies and private equity investors alleging that the companies' board composition violated Section 8. On October 19, 2022, the DOJ announced that seven directors had resigned from five corporate boards in response to concerns raised by the Antitrust Division.

The resignations unwound five alleged interlocks – in each case where at least one of the companies identified the other as a competitor in its Securities and Exchange Commission filings, although none of the companies admitted violating the law. The DOJ's press release quoted Kanter promising more enforcement actions: "The Antitrust Division is undertaking an extensive review of interlocking directorates across the entire economy and will enforce the law."

Section 8: What's an interlocking directorate?

Section 8 prohibits a "person" from serving as an officer or director of two "corporations" that are "competitors." It is a strict liability statute designed to "nip in the bud incipient violations of the antitrust laws by removing the opportunity."[1] Specifically, Section 8 seeks to prevent such interlocks from leading to the exchange of competitively sensitive information or collusion.

Violations under Section 8 generally turn on the interpretation of the terms "person," "corporation" and "competitors," as well as the applicability of certain safe harbors. The DOJ and the Federal Trade Commission (FTC) have generally taken a very broad interpretation of each of these terms – i.e., "person" is interpreted to include individuals, corporations and unincorporated entities, while "competitors" is interpreted as companies in the same industry that offer substitutable products to similar customers – though whether such broad interpretations would hold up in court is not clear.

Importantly, in enforcing Section 8 prohibitions, the DOJ is limited to seeking injunctive relief, while private parties may seek either injunctive relief or treble damages. The DOJ can and does sue for injunctive relief, the violation of which could result in civil contempt charges, but the agency has often accepted resignations and issued a press release, with the attendant adverse publicity. And public companies have in the past faced shareholder derivative suits following the announcement of violations. Companies also may face liability if interlocks lead to price fixing, market division agreements or the exchange of information that results in higher prices.

Monetary threshold and safe harbors

Section 8 does not condemn all interlocking directorates between companies that compete with one another. Both corporations must have assets on their balance sheets above the minimum amount (currently $41,034,000), which is inflation-adjusted annually.

Emerging company example: A startup company that has raised $30 million in capital falls below the

$41,034,000 Section 8 monetary threshold.[2]

There are also statutory exceptions for banks and where the competitive sales of the corporations are below minimum thresholds. Section 8 defines "competitive sales" as "the gross revenues for all products and services sold by one corporation in competition with the other … in that corporation's last completed fiscal year."[3] The competitive overlap is viewed as *de minimis*, and the interlock is not prohibited, if one of the following applies:

- The competitive sales of either corporation are less than $4,103,400. (This is the current threshold, which is subject to annual adjustment.)
- The competitive sales of either corporation are less than 2% of that corporation's total sales, which are the gross revenue for all products and services in the last completed fiscal year.
- The competitive sales of each corporation are less than 4% of that corporation's total sales.

In addition, the statute provides for a one-year grace period from the date of an intervening event (e.g., a transaction or a change in strategic direction that results in competitive sales over the threshold) that makes continued participation on the board of both firms unlawful.

Life sciences example of *de minimus* exemption: Clinical-stage pharmaceutical companies that do not generate any revenue fall into the *de minimus* exemption because they do not have "competitive sales" at all and certainly fall below the $4,103,400 exemption threshold, even if the company has assets in excess of $41,034,000.

Deep dive on key terms: Applicability to venture capital and private equity

Liability under Section 8 generally turns on the interpretation of the terms "person," "corporation" and "competitors." Interpretation of these terms has important implications, particularly to VC and PE investors.

'Person'

On its face, the statute appears to prohibit the **same individual** from sitting on the board of two competitors. But the government and private plaintiffs have taken the position that the statute captures board members deputized to represent the interests of the **same investor** – for example, a private equity firm cannot appoint one director to board A and another director to board B if A and B compete. Although the law is unsettled, this interpretation has been accepted by some courts.[4]

Importantly, the DOJ's October 2022 press release described the resignations of two directors who did not sit on a competitor's board themselves but, according to the DOJ, represented an investment firm that had a seat on a competitor's board.

'Corporation'

The term "corporation" includes private and public companies, though there is an open legal question as to whether it applies to noncorporate entities such as limited partnerships – and with many funds set up as limited partnerships, this has potential implications for VC and PE funds – and limited liability companies, although the DOJ and the FTC may push the boundaries on a broad interpretation.

'Competitors'

Section 8 prohibits an officer or director of one corporation from serving as an officer or director of another

corporation if they are “by virtue of their business and location of operation, competitors, so that the elimination of competition by agreement between them would constitute a violation of any of the antitrust laws.” This sounds straightforward, but as in other areas of antitrust enforcement, the boundaries that define the competition are not always clear.

For example, a pharmaceutical product may compete with other pharmaceutical products with the same active pharmaceutical ingredient, similar mechanism of action or same indication. On the other hand, there may be strong arguments that one product does not compete with the other because they are used at different stages of the disease state.

These terms and the scope of the safe harbors continue to be the subject of debate.

Is your board Section 8 ready?

The DOJ is actively searching securities filings and other publicly available information to identify and pursue potential Section 8 violations. Public companies therefore appear to have been a particular focus of the recent wave of resignations announced by the DOJ. But, both public and private corporations should consider implementing the following strategies to assess and minimize risk in complying with the antitrust laws.

Evaluate board compliance

Start by asking each current board member and officer to identify each company where they serve as an officer or director. For board members appointed to represent an investor, identification of other companies in which the investor has board representation should be considered.

This may be a particular challenge for VC and PE firms that invest in and have board seats on multiple portfolio companies in the same sector. Notably, in the DOJ’s October 2022 press release, four of the seven resigning board members were affiliated with investment firms. In these circumstances, counsel can help evaluate and mitigate the risk of enforcement.

Establish a protocol to evaluate potential interlocks

To prevent inadvertent violations of the antitrust laws and the potential for government scrutiny, companies should establish a protocol to identify and assess potentially problematic interlocks during the nomination process and on an ongoing basis.

Keep in mind that circumstances may change. This is particularly true for startup companies, which may have no revenues or competitive sales today, but may generate such sales in subsequent years, creating potential exposure. For this reason, even companies with no revenues should establish a protocol.

Consult counsel if you have questions about whether companies may be viewed as competitors

As with many areas of antitrust law, defining the markets in which companies compete is not always clear cut. Companies should consult with counsel before appointing any board member who sits on another board in the same industry. And, when identifying competitors in securities filings, be aware that naming companies may have the unintended consequence of creating Section 8 exposure if a board member also sits on the board of an identified competitor.

Notes

1. *United States v. Sears, Roebuck & Co.*, 111 F. Supp. 614, 616 (SDNY 1953).
2. All monetary thresholds are adjusted annually for changes in the gross national product in January.
3. 15 USC §19(a)(2)(C).
4. See *Reading Intern, Inc. v. Oaktree Capital Management*, 317 F. Supp. 2d 301, at 327-331 (SDNY 2003), and the court’s finding the “deputization” theory to be plausible and focusing on the allegations about the details of the relationships between board members.

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Key Contacts

Megan Browdie **Washington, DC**	**mbrowdie@cooley.com** **+1 202 728 7104**
Parker Erkmann Washington, DC	perkmann@cooley.com +1 202 776 2036
Dee Bansal Washington, DC	dbansal@cooley.com +1 202 728 7027
Beatriz Mejia San Francisco	mejiab@cooley.com +1 415 693 2145
David Burns Washington, DC	dburns@cooley.com +1 202 728 7147
Sharon Connaughton Washington, DC	sconnaughton@cooley.com +1 202 728 7007

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