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Director Interlocks Draw DOJ's Antitrust Attention

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The Antitrust Division of the Department of Justice has focused attention recently on an oft-overlooked provision of U.S. antitrust law prohibiting "interlocking directorates." This prohibition is found in Section 8 of the Clayton Act, 15 U.S.C. § 19, and provides that "no person shall, at the same time, serve as a director or officer in any two corporations," if those two corporations are competitors. DOJ has indicated that it intends to "reinvigorate" enforcement of this prohibition, and recently announced several instances where it had required directors to resign to resolve Section 8 concerns, including multiple board members designated to two public company boards by a prominent technology sector-focused financial sponsor. However, practical risks for companies under Section 8 are significantly narrower than those associated with other antitrust laws.

Background of Section 8

Section 8 makes it a *per se* violation of law for a "person" to serve as a director or officer of two different corporations if those corporations are competing such that "the elimination of competition by agreement between them would constitute a violation of any of the antitrust laws."[1] DOJ has interpreted the "no person" language to include situations where a single individual serves as a director of two competing companies and also where a single entity controls the directors of two competing companies (e.g., where an investment fund has the ability to appoint a director to two different competing entities).

While Section 8 creates a *per se* prohibition on interlocks, it is far different from other *per se* antitrust violations. *Per se* violations of the Sherman Act, the primary federal antitrust statute, can subject a company to criminal penalties, trebled damages, and lengthy litigation with both the government and third parties. In stark contrast, Section 8 provides no monetary penalties. As a result, Section 8 violations have historically been resolved through resignation of the interlocked individual.[2] Indeed, there has been no Section 8 enforcement at the federal level for over a decade.

Enforcement Obstacles

The DOJ's ability to use Section 8 as a tool to go after potentially problematic interlocks is limited in a few ways. First, Section 8 does not provide DOJ with the ability to seek damages for violations. Rather, the relief available is injunctive—the interlocking director can be forced to resign. In practice, this means that in order to avoid a case against the DOJ, the interlocked director can simply resign from the board. Section 8 does provide for private right of action, and has been used in the past by an interlocked company in an effort to protect against an activist investor.[3] However, Section 8 does not provide any ability for a private plaintiff to seek monetary damages for a violation.

In addition, Section 8 on its face applies to "corporations." To the extent that directors are appointed to boards of competing non-corporate entities (limited liability companies, for example), such "interlocks" are not covered by Section 8 on its face. Moreover, while DOJ has some meaningful ability to seek out interlocks involving public companies based on SEC reporting, the ability to track down interlocks among privately-held corporations (including those held by private equity funds) is likely to be much more limited. Given the prevalence of governing boards of financial sponsors' private portfolio companies typically being in non-corporate holding companies, Section 8 exposure for financial sponsors may be limited.

There are other antitrust laws that might be used to address DOJ concerns over interlocks, but they have their own limitations. For example, DOJ could pursue an action under Section 1 of the Sherman Act (prohibiting agreements in restraint of trade, including collusion), but a Section 1 complaint would target the companies, rather than the director(s), and would require a showing of an agreement that reduces competition in some way, presumably facilitated by the interlock, rather than merely pointing to the interlock itself.

Practical Guidance for Investors and Companies

Given the DOJ's renewed focus on Section 8 enforcement, there are four key takeaways for companies and investors.

First, when considering new acquisitions, investors should consider whether the acquisition of an appointment right for the new investment might bring them within the ambit of Section 8, now or in the future. If Section 8 may come into play, it may be prudent to consider redundant or alternative means of protecting the investment or providing oversight.

Second, corporations should evaluate their existing boards to determine if any Section 8 liability may arguably exist or may exist in the future based on expanding sales or new acquisitions. If so, appropriate steps should be taken to eliminate the Section 8 concern. More importantly, it would be wise to consider whether sufficient protections exist to prevent the flow of competitively sensitive information, which could be a problem independent of the Section 8 concern.

Third, DOJ's renewed interest may pose challenges for activist investors waging proxy contests. If an activist investor seeks to nominate a new director, public companies should evaluate whether the investor has any other holdings that might bring Section 8 into play, including with respect to future competition. That said, if an activist investor seeks to appoint an unaffiliated third party to a board or secure a veto right for such an unaffiliated person, it's unclear to what extent Section 8 could be used in this context, but the prospect of DOJ attention may counsel in favor of additional caution.

Fourth, large investors may benefit from thinking proactively on how to avoid Section 8 concerns in the context of new investments. For example, holding a board seat at a public company level might be a violation, but nominating a director to a non-corporate holding company may accomplish some of the same benefits without directly running afoul of Section 8.

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If you have any questions concerning these developing issues, please do not hesitate to contact either of the following Paul Hastings Washington, D.C. lawyers:

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[1] Section 8's applicability is limited to companies that have capital, surplus, and undivided profits of greater than an inflation-adjusted threshold currently set at approximately $41 million. In addition, the statute provides a few *de minimis* exceptions to the general rule that focus on the quantity of the parties' respective sales of overlapping products. These exemptions are:

- If either party's sales of overlapping products are less than an inflation-adjustment amount, which is currently $4.1 million;
- If either party's sales of overlapping products are less than 2% of that party's total sales; and
- If both parties' sales of overlapping products are less than 4% of their respective total sales.

[2] Section 8 also provides a grace period for newly-created interlocks. This might arise where an interlock results from a company's acquisition of another business or where the company's sales of competing products expand to exceed the *de minimis* threshold. In such circumstances, as long as the affected officer or director was eligible as of the time of appointment, he or she has one year before being deemed to be in violation of Section 8.

[3] http://www.sec.gov/Archives/edgar/data/732485/000110465910026213/a10-9595_1defa14a.htm.

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