WHO IS A COMPETITOR UNDER SECTION 8?

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The Department of Justice Antitrust Division has recently been investigating public companies for possible violations of Section 8 of the Clayton Act, 15 U.S.C. § 19, based on information listed in the Risk Factors section of their annual and quarterly SEC filings. Section 8 prohibits "interlocking directorates," situations in which an individual or entity serves as a director or officer of two corporations that are "competitors." So far, the Departments efforts have appeared to focus on interlocks in which one company named the other as a competitor in a public filing. In this article, we explain that the "competitors" listed in a public company's SEC filings are not necessarily competitors within the meaning of Section 8.

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I. INTRODUCTION

The Department of Justice Antitrust Division ("DOJ") has recently been investigating public companies for possible violations of Section 8 of the Clayton Act, 15 U.S.C. § 19, based on information listed in the Risk Factors section of their annual and quarterly SEC filings. Section 8 prohibits "interlocking directorates," situations in which an individual or entity serves as a director or officer of two corporations that are "competitors." As Deputy Assistant Attorney General Andrew Forman recently stated, "the Division is committed to taking aggressive action" against board interlocks.[2]

So far, DOJ's efforts appear to focus on interlocks in which one company named the other as a competitor in a public filing. Academic commentators have also latched onto companies listed as competitors in public filings as strong evidence of illegal interlocks where the company making the disclosure and the purported competitor have a board member in common. In a recent economic study into the prevalence of interlocking directorates, the authors posited that the "most stringent method of identifying competitors is when companies self-report their competitors in their regulatory filings."[3]

Whether courts would agree remains to be seen. So far, there is only one litigated case in which an interlock was alleged on the basis of a 10-K filing. In *in re eBay Inc. Derivative Litigation*, 2011 WL 3880924 (D. Del. 2011), eBay shareholders brought a derivative suit based on an alleged interlock between eBay and the New York Times. eBay had disclosed in its 2009 10-K filing that it competed with "online and offline classifieds platforms." Because the New York Times' newspaper features classified ads, the shareholders alleged that the interlock with the New York Times violated Section 8. The court did not reach the question of whether the two corporations compete, so the weight of 10-K filings in Section 8 litigation is still an open question.

In this article, we explain that the "competitors" listed in a public company's SEC filings are not necessarily competitors within the meaning of Section 8.

I. ABOUT SECTION 8

Competitors with interlocking boards are strictly liable for violating Section 8, without regard to whether the interlock caused harm to competition. An antitrust agency that proves an illegal interlock may be entitled to an injunction mandating the interlocking director to step down and/or requiring the corporations to submit to compliance monitoring. However, companies that share a director have several possible defenses to a Section 8 claim. Section 8 applies only to public or private corporations – LLCs and other non-corporate entities are exempt. Both corporations must have U.S. operations or sales. Banks, banking associations, and trust companies are exempt. Section 8 does not apply if either corporation's net worth is less than an annually adjusted threshold amount, currently set at $45 million.[4]

Perhaps the most common defense to a Section 8 claim is that competitive sales are *de minimis*. Congress amended Section 8 in 1990 to carve out insignificant interlocks, reasoning that a "ban on interlocking directorates serves no functional purpose where the corporations are not in competition with one another to a significant degree or where they compete in a line of business that is not economically significant in relation to their overall operations."[5] Corporations with interlocking directors do not violate Section 8 if either corporation's annual "competitive sales" are less than 2 percent of its total revenue; each corporation's annual "competitive sales" are less than 4 percent of its total revenue; or either corporation's annual "competitive sales" are less than an annually-adjust threshold amount (currently $4.5 million).[6]

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2 Andrew Forman, Deputy Assistant Attorney General, *The Importance of Vigorous Antitrust Enforcement in Health Care* (June 3, 2022).

3 Mark A. Lemley et al., Analysis of Over 2,200 Life Science Companies Reveals a Network of Potentially Illegal Interlocked Boards (Stanford Law Working Paper No. 578, 2022), http://ssrn.com/abstract=4253144.

4 Federal Trade Commission, *FTC Announces 2023 Update of Size of Transaction Thresholds for Premerger Notification Filings and Interlocking Directorates* (Jan. 23, 2023), https://www.ftc.gov/news-events/news/press-releases/2023/01/ftc-announces-2023-update-size-transaction-thresholds-premerger-notification-filings-interlocking. The statutory phrase "capital, surplus, and undivided profits" means net worth. *See Protectoseal Co. v. Barancik*, 1993 U.S. Dist. LEXIS 12299 (N.D. Ill 1993), *aff'd* l 23 F.3d 1184 (7th Cir. 1994).

5 H.R. Comm. on the Judiciary, Report on Antitrust Amendments Act of 1990, P.L. 101-588, 104 Stat. 2879, at 7 (May 14, 1990) [hereinafter *House Judiciary Report*].

6 Federal Trade Commission, *FTC Announces 2023 Update of Size of Transaction Thresholds for Premerger Notification Filings and Interlocking Directorates* (Jan. 23, 2023), https://www.ftc.gov/news-events/news/press-releases/2023/01/ftc-announces-2023-update-size-transaction-thresholds-premerger-notification-filings-interlocking.

Any violation of Section 8 must involve two corporations that are "competitors." It is important to note that the word "competitors" means different things in different contexts. Antitrust lawyers are of course familiar with this concept. A firm's competitors in its primary product market may not be its competitors for other product lines and it may have a wholly different set of competitors in labor markets. Two firms which would be considered as parts of separate markets in a Section 7 case might still have sufficient overlap to warrant precautions about sharing competitively sensitive information. And this is just within antitrust law.

II. COMPETITORS IN RISK FACTORS

The use of the term competitor in a company's risk factors on SEC filings is yet another variation on the definition, applicable to a different body of law than antitrust. Risk factors in SEC disclosures are drafted by the business in conjunction with public company lawyers. Antitrust lawyers are typically not involved in this process. The purpose of disclosing potential competitors in risk factors is to head off potential securities lawsuits. If a public company's stock drops due to some unforeseen event, this often leads to a wave of class action lawsuits from investors alleging the company made misleading statements in its public disclosures. Risk factors serve as a barrier against these suits: if the company disclosed that the unforeseen event was possible, it stands a better chance of winning on motion to dismiss, and therefore the settlement value of these types of investor suits will be lower.

The securities laws do not lay out criteria that a public company must use in determining which companies to list as competitors. In fact, a company is not required to list any specific competitors by name. As such, companies take varied approaches to disclosing risks from competition based on their own risk tolerance. For example, the short-term rental app provider Airbnb, Inc. names a host of companies offering travel-related services as its competitors in its Form 10-K filing:

"We compete to attract and retain guests to and on our platform, as guests have a range of options to find and book accommodations and experiences. … Our competitors include:

> · Online travel agencies ("OTAs"), such as Booking Holdings (including the brands Booking.com, KAYAK, Priceline.com, and Agoda.com); Expedia Group (including the brands Expedia, Vrbo, HomeAway, Hotels.com, Orbitz, and Travelocity); Trip.com Group (including the brands Ctrip.com, Trip.com, Qunar, Tongcheng-eLong, and SkyScanner); Meituan Dianping; Fliggy (a subsidiary of Alibaba); Despegar; MakeMyTrip; and other regional OTAs;
> · Internet search engines, such as Google, including its travel search products; Baidu; and other regional search engines;
> · Listing and meta search websites, such as TripAdvisor, Trivago, Mafengwo, AllTheRooms.com, and Craigslist;
> · Hotel chains, such as Marriott, Hilton, Accor, Wyndham, InterContinental, OYO, and Huazhu, as well as boutique hotel chains and independent hotels;
> · Chinese short-term rental competitors, such as Tujia, Meituan B&B, and Xiaozhu; and
> · Online platforms offering experiences, such as Viator, GetYourGuide, Klook, Traveloka, and KKDay."[7]

By contrast, the dating app provider Bumble Inc. describes its competitive set in general terms without naming any specific competitors:

> "The online dating industry is fast growing and highly competitive. We compete with a number of companies that provide dating products and services for the same markets in which we operate. … In addition, while we compete with other online dating platforms, offline forms of dating are sources of competition as well. We compete with offline dating services, such as in-person matchmakers, as well as more traditional forms of dating that involve people meeting offline without the use of dating products or services altogether. Because of the extensibility of the Bumble app platform beyond dating, we also compete with social media and networking platforms."[8]

7 Airbnb, Inc., 2021 Annual Report on Form 10-K, https://s26.q4cdn.com/656283129/files/doc_financials/2021/q4/2a413af0-3429-4317-9d3c-a71f2d6d2683.pdf.

8 Bumble Inc., 2021 Annual Report on Form 10-K, https://s202.q4cdn.com/372973788/files/doc_financials/2022/ar/Bumble-Inc.-Annual-Report-2021.pdf.

III. COMPETITORS UNDER SECTION 8

The term "competitors" has a specific meaning under Section 8 that differs from meanings the same word may have in public company filings or even other types of antitrust cases.

Section 8 prohibits interlocks between corporations that 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 definition, as a start, tells us that there must be overlap in both the product market and the geographic market for the companies to be considered competitors under Section 8.[9]

The required product market and geographic overlap must be current (rather than future), and it must be for the sale of goods or services. This is stands in contrast to competition under the Sherman Act and Section 7 of the Clayton Act, both of which govern a wider set of competitive circumstances, including competition to purchase labor or other inputs, competition to innovate, and competition that might take place in the future.[10]

Any doubt on this point was laid to rest in 1990, when Congress amended Section 8 to provide safe harbors for interlocks between corporations with *de minimis* "competitive sales." Congress defined "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," which made clear that Section 8 affects only corporations with current overlapping sales.

Case law provides additional insight into how competition should be considered under Section 8. Although the antitrust agencies have enforced Section 8 only sporadically, the statute passed in 1914 and there have been several litigated cases over the last 100+ years. As the Senate Judiciary Committee noted at the time of the 1990 amendments: "The courts have looked to a wide variety of factors to determine whether competition exists."[11] Courts have not performed a surface-level analysis, simply declaring companies as competitors if they participate in the same industry or offer similar-sounding products. While they have sought to avoid the complex economic analysis they would undertake in a merger challenge,[12] courts have given a close look at competitive dynamics and the products or services at issue to determine whether the defendants truly do compete.[13]

For instance, functional differences between the corporations' respective offerings can show they are not competitors within the meaning of Section 8. For instance, in *American Bakeries Co. v. Gourmet Bakers, Inc.*,[14] each party sold bakery supplies to grocery stores and fast food chains, but the court held it would be "facile" to view it at this level of generality and find the parties competed. Rather, the court looked to "traditional tests of competitiveness": (1) whether the products are reasonably interchangeable in their uses and (2) whether customers are likely to switch between them in response to a price increase. For grocery store customers, the parties were not competitors because the products sold were not functionally interchangeable: American produced and sold fresh baked goods, while Gourmet purchased and resold frozen doughs. Similarly, in *Borg-Warner*, the FTC's administrative law judge looked closely to determine whether two manufacturers of similar hydraulic pumps and valves actually competed.[15] Both manufacturers, Bosch U.S. and Borg-Warner, offered hydraulic pumps and valves that were used in aero-

9 *United States v. Crocker National Corp.*, 422 F. Supp. 686, 703-04 (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).

10 *See, e.g., Todd v. Exxon Corp.*, 275 F.3d 191 (2d Cir. 2001) (labor competition); *Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co.*, 549 U.S. 312 (2007) (purchasing competition); *In the Matter of Illumina, Inc. and GRAIL, Inc.*, Fed. Trade Comm'n, https://www.ftc.gov/legal-library/browse/cases-proceedings/201-0144-illumina-inc-grail-inc-matter (innovation competition); *United States v. Falstaff Brewing Corp.*, 410 U.S. 526 (1972) (potential competition).

11 S. Comm. on the Judiciary, Report on Antitrust Amendments Act of 1990, P.L. 101-588, 104 Stat. 2879 (May 14, 1990) [hereinafter *Senate Judiciary Report*].

12 See *Protectoseal Co. v. Barancik*, 484 F.2d 585, 589 (7th Cir. 1973) ("We do not believe Congress intended the legality of an interlock to depend on the kind of complex evidence that may be required in a protracted case arising under § 7.).

13 See H.R. Comm. on the Judiciary, Report on Antitrust Amendments Act of 1990, P.L. 101-588, 104 Stat. 2879 (May 14, 1990) [hereinafter *House Judiciary Report*] ("While the case law interpreting section 8 has not been abundant, it does seem clear that for the prohibition to apply, there must be an interlock between corporations that actually compete.").

14 515 F. Supp. 977 (D. Md. 1981).

15 *In re Borg-Warner*, 101 F.T.C. 863, 1983 FTC LEXIS 69, at *64-68 (FTC 1983); *rev'd on other grounds, Borg-Warner v. FTC*, 746 F.2d 108 (2d Cir. 1984).

space, industrial, and mobile equipment applications.[16] The pumps and valves were "functionally similar."[17] However, Bosch's pumps and valves were designed to work at high pressure, while Borg-Warner's pumps and valves were designed to work at low pressure, so the two were not interchangeable and therefore did not compete.[18]

A different business model might also render two corporations non-competitors for Section 8 purposes. In *American Bakeries*, the court ruled out competition to serve fast food chain customers on this ground. Burger King purchased steak rolls from American while McDonalds used Gourmet to source steak rolls. However, the court found the parties did not compete in this regard because American acted as a manufacturer/supplier while Gourmet acted as a purchasing agent. Similarly, in *Paramount Pictures Corp. v. Baldwin-Montrose Chemical Co.*,[19] the court held that an agent that helped television production companies sell programs to networks did not compete with Paramount, which produced its own programs and sold them to networks itself. The agent did not compete in the market for television programs because it did not control "to whom and at what price the program shall be sold." Conversely, Paramount did not compete in the agency business because it never sought to acquire principals other than itself.

There have been no cases interpreting the definition of competitors under Section 8 since the time of the 1990 amendments, so the principles described above represent the current state of the law.[20]

IV. THE TROUBLE WITH USING RISK FACTORS TO IDENTIFY SECTION 8 VIOLATIONS

As Congress has recognized, "directoral interlocks are commonplace and generally do not threaten competition."[21] The problem with interlocks among competitors is that the common director could use her influence at each corporation to get the corporations to compete less vigorously (to their joint benefit, but at the expense of their customers), or she could share key competitive secrets across the two entities, leading to the same result. Interlocks among non-competitors in the same general industry do not pose this same danger. To the contrary, such interlocks can be procompetitive, as a director that is knowledgeable about a given industry and experienced in serving on corporate boards can go a long way towards improving a corporation's performance.

Using risk factors to identify Section 8 violations is likely to be over-inclusive, causing the Department and businesses to waste time, effort, and money on investigations that are ultimately fruitless.

Consider Airbnb. Airbnb discloses competition with hotel chains such as Marriott and Hilton, but it serves a different role in the travel industry than these companies do and given the current state of law, a court would likely not consider these companies competitors under Section 8. Marriott and Hilton generate revenue by managing hotels on behalf of property owners, by licensing their brands to franchisees, and by owning and operating hotels. In contrast, Airbnb offers a platform that connects property owners offering short-term vacation rentals with prospective guests – it makes money by charging service fees to property owners and guests. Under the analysis of *Paramount and American Bakeries*, these companies likely do not compete.

Or consider Bumble. Bumble offers an online dating platform that allows users to create a profile, "swipe" through potential dates, and communicate with "matches." The app is free to use and generates revenue by offering premium features to a subset of users. In its 10-K filing, Bumble discloses competition with off-line matchmaking services. While these services serve the same basic function – helping users find dates – there are significant differences such that most users would not consider such services interchangeable.

Even where corporations do compete in the same product and geographic market, the statute might not apply due to the statutory safe harbors. Section 8 does not apply if the annual competitive sales of either corporation account for less than 2 percent of the company's sales or

16 *Id.* at *64-66.

17 *Id.* at *64-66.

18 *Id.* at *68 ("although performing the same function, [the pumps and valves] were not interchangeable because of significant physical and performance characteristics"). The administrative law judge did not give any weight to the possibility that customers could substitute the products by redesigning their hydraulic systems to work with one or the other type of pump. *Id.*

19 1966 U.S. Dist. LEXIS 10596 (S.D.N.Y. 1966).

20 *Senate Judiciary Report* at 6 ("It is not the intention of the committee to alter the way in which courts have determined whether products or services sold by one corporation are in competition with products or services sold by another corporation.").

21 *House Judiciary Report* at 4.

are below a certain threshold (currently $4.5m). Corporations sometimes list competitors with which they overlap only in minor product lines. For example, Bumble discloses that "[b]ecause of the extensibility of the Bumble app platform beyond dating, we also compete with social media and networking platforms." This presumably refers to "Bumble BFF" and "Bumble Bizz," features of the Bumble app that allow users to "swipe" for platonic friendships or professional connections. It is possible that these features account for less than 2 percent of Bumble's revenue.

Companies might overlap in their main product lines and still meet the *de minimis* criteria if the products have not yet started to generate significant competitive sales. In Lemley et al.'s study of interlocks among public companies in the life sciences industry, more than 80 percent of the interlocks identified involved at least one company with less than $5 million in all-time historical revenue. Most such interlocks are not illegal. Antitrust enforcers should be cautious about discouraging legal interlocks in the life sciences industry. As Lemley and his coauthors note, life sciences start-ups often "require officers and board members with the rare domain expertise required to usher cutting-edge, disease-specific products through clinical trials and into the market."

V. CONCLUSION

The competitors listed in a public company's risk factors disclosure may or may not be the same as its competitors for the purposes of Section 8 of the Clayton Act. Therefore, we encourage antitrust enforcers to search public sources for additional evidence of competition before issuing subpoenas based on public companies' risk factor disclosures.

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