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## *Motorola Mobility* and the FTAIA: A Deterrence-Based Definition of "Direct" Effect

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# *Motorola Mobility* and the FTAIA: A Deterrence-Based Definition of "Direct" Effect

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## I. INTRODUCTION

In *Motorola Mobility LLC v. AU Optronics*,[2] the Seventh Circuit Court of Appeals offers an interpretation of the Foreign Trade Antitrust Improvements Act ("FTAIA"), 15 U.S.C. §6a that has significant implications for the right to sue foreign companies under the Sherman Act. Here, I offer a different interpretation that is grounded in the objective of deterring harm to U.S. commerce.

## II. *MOTOROLA MOBILITY* AND "DIRECT" EFFECTS

The FTAIA states that the Sherman Act "shall not apply to conduct involving trade or commerce … with foreign nations." but provides some exceptions to that rule. The exception of relevance to *Motorola Mobility* is that foreign companies are liable under the Sherman Act when their conduct has "a direct, substantial, and reasonably foreseeable effect" on U.S. commerce and "such effect gives rise to a claim under [the Sherman Act]." *Motorola Mobility* involves an alleged cartel of foreign manufacturers of liquid crystal display ("LCD") panels used in mobile phones. In a decision written by Judge Richard Posner, the LCD manufacturers were found not liable because their conduct did not have a "direct" effect and thus did not fall into the above-stated exception to the FTAIA:[3]

> The alleged price fixers are not selling the panels in the United States. They are selling them abroad to foreign companies (the Motorola subsidiaries) that incorporate them into products that are then exported to the United States for resale by the parent. The effect of component price fixing on the price of the product of which it is a component is indirect …

Courts have wrestled with what the U.S. Congress might have meant by "direct," which has served to produce a litany of definitions. The Seventh Circuit concluded that there was no direct effect in the Motorola case because the effect is "remote,"[4] which is a term used in the *Minn-Chem* decision.[5] *Minn-Chem* drew upon the Ninth Circuit Court when it said that "direct" means that "it follows as an immediate consequence of the defendant's activity,"[6] and that an

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[1] Patrick T. Harker Professor, Department of Business Economics & Public Policy, The Wharton School, University of Pennsylvania, Philadelphia, PA 19107 USA harrij@wharton.upenn.edu. Without implicating them for the arguments presented here, I am grateful for the comments of Dave Barth, Eleanor Fox, Chip Miller, Bill Page, and Abe Wickelgren

[2] *Motorola Mobility LLC v. AU Optronics*,[2] No. 14-8003, 2014 WL 1243797 (7th Cir. Mar. 27, 2014).

[3] *Id.* at 4-5.

[4] *Id.*, at 4.

[5] *Minn-Chem, Inc. v. Agrium, Inc.,5 683 F.3d 845 (7th Cir. 2012).*

[6] *United States v. LSL Biotechs.*, 379 F.3d 672, 680 (9th Cir. 2004)

effect is not direct when "it depends on … uncertain intervening developments."[7] However, in a recent decision, the Second Circuit Court found "immediate consequence" too stringent and instead interpreted "direct" as meaning that there is a "reasonably proximate causal nexus between the conduct and the effect."[8]

### A. Meeting the Primary Objective of the FTAIA

Focusing on what it means to be "remote" or of "immediate consequence" or "reasonably proximate" does not seem to bring us any closer to a useful definition in that each term is as ill-defined as the preceding one. What is lacking is a guiding principle for determining whether an effect is direct. The approach I take here is grounded in a primary objective of the FTAIA and that defines "a direct, substantial, and reasonably foreseeable effect" on U.S. commerce in a manner consistent with that objective. The presumption is that the U.S. Congress had certain objectives in passing the FTAIA and that the terms were chosen to best achieve those objectives.

The FTAIA seeks to balance comity and the protection of U.S. commerce; that the United States should not intervene with regards to foreign conduct except when it creates harm for U.S. commerce. It was recognized that any interference into how a foreign nation conducts its affairs should not be done without sufficient cause, which is a rationale for why there must not just be harm but "substantial" harm.

Given that the FTAIA pertains to when foreign conduct is liable under the Sherman Act, harm refers to that caused by anticompetitive conduct. It is well-accepted that a (if not, the) primary focus of antitrust law and enforcement is *deterrence*; it is better to *ex ante* deter anticompetitive behavior than to *ex post* disrupt and punish anticompetitive conduct. Deterrence is especially valued in this setting because interfering in the conduct of foreign nations runs counter to sovereignty, which thereby puts a premium on avoiding the need for intervention. The guiding principle of the approach taken here is to assume that the "direct, substantial, and reasonably foreseeable effect" exception was made in order to deter foreign conduct that harms U.S. commerce, and to then interpret "reasonably foreseeable" and "direct" so as to most effectively achieve that objective.

### B. Using the Deterrence Lens

What is necessary to deter companies from engaging in anticompetitive conduct that causes harm to commerce? The first condition is that a company must know which actions create harm so that it knows to avoid such actions. Of course, deterrence also requires a company believe that by acting in a manner that creates harm, the chances of it being held liable (and penalized) are greater than if it were not to take a harm-creating action. This leads to the second condition, which is that a company must believe that it is more likely to be found liable if its conduct causes harm than when it does not. Deterrence then requires that liability be closely tied to the presence of a causal relationship between a company's conduct and harm. If companies are found liable too frequently (e.g., they are liable whether or not the conduct caused harm) or too infrequently (e.g., they are not liable whether or not the conduct caused harm) then behavior will not be deterred because a company's action has little effect on the legal consequences.

[7] *Id.* at 681.

[8] *Lotes Co., Ltd. v. Hon Hai Precision Industry Co.*, No. 13-2280 (2nd Cir., June 4, 2014)

Through the lens of deterrence, let us determine what it means for conduct to have an effect on U.S. commerce that is "reasonably foreseeable" and "direct." That the effect must be "reasonably foreseeable" is to require that it is reasonable to expect a company to be aware that its conduct would cause harm. A foreign company cannot be deterred from harming U.S. commerce if it does not realize that its actions would have such an effect. At the same time, a foreign company should not be incentivized to engage in conscious neglect of how their actions may impact U.S. commerce. Hence, it is not required that a foreign company be actually aware that its actions would create harm, but rather that it should be aware that its actions would create harm. The requirement that the effect is "reasonably foreseeable" satisfies the first necessary condition for deterrence.

Now we come to the source of contention; what it means for an effect to be "direct." In applying the second necessary condition for deterrence, I propose that an effect is "direct" if it can be determined that the observed harm was caused by the actions of the company. That is, there is a clear path from conduct to harm that one can confidently conclude that the harm was caused by that conduct. This interpretation is consistent with that suggested by Judge Ruggero Aldisert in his dissenting opinion in *LSL Biotechs*,[9] which is that "direct" is "characterized by or giving evidence of a close especially logical, causal, or consequential relationship." This definition serves the objective of deterrence because if foreign companies anticipate that they will be held liable when it is established that their conduct caused harm, then they will be less inclined to pursue conduct that causes harm.

That conduct has a "reasonably foreseeable" effect in producing harm is an *ex ante* criterion: A company should have anticipated that its action would cause harm. That conduct has a "direct" effect in producing harm is an *ex post* criterion: It can be determined that the measured harm was caused by the company's conduct.

To draw out the distinction, consider the following situation: If the foreign manufacturers of LCD panels could not have known that the purchasers would install those panels in devices that would be sold in the United States then they could not reasonably have foreseen that their conduct would affect U.S. commerce. At the same time, an *ex post* analysis could determine that higher prices for LCD panels paid by Motorola's foreign subsidiaries resulted in higher prices for mobile phones sold in the United States. In this scenario, a cartel among LCD panel manufacturers would have had a direct, but not reasonably foreseeable, harmful effect on U.S. commerce.

### C. The Motorola Mobility Decision Does Not Deter

By comparison to the above scenario, the definition of "direct" used by the Seventh Circuit in *Motorola Mobility* does not satisfy the goal of deterrence. Consider the following two scenarios: In scenario I, there is a high pass-through rate of the price paid for inputs by the foreign subsidiaries to the final price for mobile phones sold by Motorola in the U.S. market, and the causal mechanism by which pass-through occurs can be identified. In scenario II, the pass-through rate is low (because the foreign subsidiaries or Motorola absorb most of the cost) and/or the pass-through mechanism cannot be clearly established.

[9] *LSL Biotechs*,[9] 379 F.3d (at 698)

According to the ruling of the Seventh Circuit, the effect is "indirect" in both scenarios and, therefore, the LCD panel manufacturers are not liable under the FTAIA. However, if the FTAIA is intended to balance comity with the prevention of harm to U.S. commerce then the two scenarios should be treated differently. The conduct in scenario I should be deterred, while that in scenario II does not warrant intervention. In scenario I, the conduct of foreign LCD panel manufacturers has a causal effect in creating substantial harm on U.S. commerce and, therefore, it serves the goal of deterrence if those manufacturers know they would be held liable under such circumstances. Interpreting an effect as "direct" when it can be established that there is a causal relationship between conduct and harm will then hold firms liable under scenario I while not under scenario II, and that is consistent with the goals of the FTAIA.

### *D. Creating a Liability Loophole*

Potentially even more detrimental to the cause of preventing harm to U.S. commerce, the Seventh Circuit's definition of "direct" effect would seem to provide a vertical disintegration loophole for avoiding liability. Consider a cartel of foreign manufacturers, each of whom has created a company for exporting their products to the United States. The manufacturers sell the products at collusive prices to the exporting companies who then sell them in the United States. The exporting companies are not liable as they are not coordinating on price and, by the interpretation of the Seventh Circuit, the manufacturers are not liable either. As long as there is an unspoken understanding that an exporting company does not sue the manufacturer that created it, the cartel has succeeded in colluding and creating harm in the U.S. market without creating liability. As it is difficult to believe the FTAIA intended to exempt that sort of behavior, again the Seventh Circuit's definition of "direct" effect runs counter to the objective of the FTAIA.

Consistent with deterring harm to U.S. commerce while taking into account foreign sovereignty, the interpretation of "direct" that is proposed here sets a more demanding standard for proving liability for foreign firms. In the case of *per se* violations for domestic firms, it is unnecessary to prove harm. In contrast, we are arguing that establishing a "direct" effect means showing the behavior caused harm. In that same spirit of a higher bar for plaintiffs, the requirement that the harm is "reasonably foreseeable" gives foreign companies immunity if they could not have foreseen their actions would harm U.S. commerce. To be liable under the "direct, substantial, and reasonably foreseeable effect" exception of the FTAIA, there must be harm, the companies should have known their conduct would cause harm, and it is established that their conduct did cause harm.

### *E. Effects on Direct Purchasers Standard*

Let me next dispense with an alternative interpretation of "direct" to that proposed here, which is that the FTAIA meant for it to refer to the status of those harmed; more specifically, there must be a substantial and reasonably foreseeable effect on *direct* purchasers. If that was the intent of the FTAIA then, given the well-accepted term of "direct purchaser" since the time of *Illinois Brick,*[10] presumably the act would have specifically referred to direct purchasers. Nor do I

[10] *Illinois Brick Co. v. Illinois* 431 U.S. 720 (1977).

think it is appropriate to ascribe this interpretation to the Seventh Circuit. Again, if that were the intent, then Judge Posner would presumably have said so.

Furthermore, Judge Posner not only argued that the effect was not direct but made a separate argument that the "derivative injury" did not give rise to a claim. However, if direct effect were being interpreted as involving a direct purchaser, it would be redundant to trot out the same argument again to conclude the plaintiffs do not have standing to state a claim. Either the Seventh Circuit's decision is unnecessarily murky or there is more going on than interpreting direct effect as harming a direct purchaser.

## III. GIVING RISE TO A SHERMAN ACT CLAIM

The preceding discussion touches on a requirement for liability under the FTAIA that I have not addressed, which is that the conduct "gives rise to a [Sherman Act] claim." Here, I refer the reader to the compelling "Brief of the American Antitrust Institute as *Amicus Curiae* in Support of Appellant's Petition for Rehearing *En Banc*" (April 24, 2014) where it is argued, also from the perspective of deterrence, that the Seventh Circuit's ruling leaves no one to pursue a legal case which means harmful conduct is neither deterred nor disrupted:[11]

> [I]f indirect purchasers, because of *Illinois Brick*, cannot bring suit against international cartels that increase end product prices in the U.S., and direct purchasers of components abroad—who are their surrogates under *Illinois Brick*—also cannot bring suit because of the FTAIA, and the government likewise cannot sue, then common cartel conduct will be completely undeterred by the Sherman Act.

## IV. CONCLUSION

In conclusion, I argue that it follows from the objective of the FTAIA to deter foreign companies from inflicting anticompetitive harm on U.S. commerce that foreign companies should be held liable for:

1. conduct which they should have anticipated would cause harm (that is, it is "reasonably foreseeable"); and
2. it can be determined that the observed harm was caused by the conduct of those companies (that is, it is "direct").

[11] "Brief of the American Antitrust Institute as *Amicus Curiae* in Support of Appellant's Petition for Rehearing *En Banc*" (April 24, 2014), pp. 9-10.

COMPETITION POLICY INTERNATIONAL

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## Extraterritoriality and Input Cartels:
## Life in the Global Value Lane—The Collision Course with *Empagran* and How to Avert It

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# Extraterritoriality and Input Cartels

## Life in the Global Value Lane: The Collision Course with *Empagran* and How to Avert It[1]

### I. INTRODUCTION

There is a looming danger that judge-made exceptions from U.S. antitrust law for foreign conduct are swallowing the proscriptions of the Sherman Act against modern-style international cartels. The danger has raised its head in the context of input cartels and, in particular, in the case of *Motorola Mobility v. AU Optronics* in the Seventh Circuit[2] and its sister cases in other circuits. The danger stems from a wrong move of the Supreme Court in *Empagran*,[3] which has laid a path that misframes analysis of the Sherman Act's reach.

To explain the point, I revert to pre-*Empagran* analysis of both the *Motorola* facts and the *Empagran* facts. I then show where *Empagran* went wrong and suggest that the Court never would have taken the tack it took if the *Motorola* fact-set had come first. I then suggest how to correct the error.

### II. THE FACTS: *MOTOROLA MOBILITY* AND *EMPAGRAN*

Let me first juxtapose the facts of *Empagran* as the Supreme Court assumed them to be, and the facts of *Motorola Mobility*. Allow me license to omit geography in the first instance, and to back into it.

Motorola makes and sells cell phones. It purchases parts and assembles them into cell phones, and it sells the cell phones in the United States and elsewhere. It turns out that the makers of an essential component—liquid crystal display ("LCD") panels—had a price-fixing conspiracy. Can Motorola successfully sue the price-fixers? Of course. This is a quintessential cartel damages case.

A quarter century ago, Motorola would have purchased the inputs from U.S. manufacturers. But times have changed. The world has globalized. U.S. manufactures have declined exponentially as a percentage of GDP. Motorola, like other U.S. businesses, faces intense pressure from global competition. To be, and to remain, competitive, it must scour the world for best execution—which commonly means outsourcing parts and assembly to Asian locations, thus organizing a global value chain, and thus incidentally helping to interconnect the world's economies. In the 21st century, global value chains are a usual way of doing business.

Admitted to the chain, the parts' makers know that they are making the parts for assembly into products that will be shipped to the brand manufacturer; the Motorola parts

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[2] Motorola Mobility LLC v. AU Optronics Corp., 746 F.3d 842 (7th Cir. Mar. 27, 2014), rehearing granted, opinion vacated (7th Cir. July 2014).

[3] F. Hoffmann-LaRoche Ltd. v. Empagran S.A., 542 U.S. 155 (2004).

makers know that they are making parts for the Motorola cell phone. If the parts' makers at the top of the global value chain conspire with their rivals to fix prices, their price-fixing agreement is like a bullet straight through to the phone buyer's purse.[4]

So, in the real *Motorola Mobility* case, the LDC panels were made in Korea, Japan, China, and Taiwan. Despite the clear illegality of the conduct in their country, in the destination country, and in almost every other country of the world, these manufacturers conspired to raise prices. They sold the panels, at prices negotiated by Motorola, to Motorola subsidiaries in China and Singapore. The Motorola subsidiaries shipped 42 percent of the assembled cell phones to Motorola-U.S. for sales in the United States and abroad. They sold 57 percent of the panels directly to buyers abroad. Motorola-U.S. bought 1 percent of the panels directly from the manufacturers (and everyone agrees, as they must, that the Sherman Act applies to the 1 percent). Does Motorola lose 99 percent of its cause of action under the Sherman Act because it buys and assembles parts through its global value chain?

Now we turn to the *Empagran* facts as assumed (it turned out, inaccurately) by the U.S. Supreme Court: There were world conspiracies, largely of European and Asian firms, to fix the price of vitamins. The price-fixing harmed the United States, and caused independent foreign injury. Distributors from Ukraine, Ecuador, Paraguay, and Australia bought price-fixed vitamins in non-US markets. Could these buyers sue the price-fixers under the U.S. Sherman Act? No. Post-*Empagran*, pre-*Empagran*, and pre-FTAIA,[5] their claim had no causal relationship to U.S. commerce. The United States had no interest in protecting these foreign plaintiffs against the foreign defendants (unless it would, altruistically, take the mantle of a world court for antitrust).

The Supreme Court gave plaintiffs leave to replead, to show that the foreign injury was not independent of the U.S. effects. Plaintiffs did so replead. But even so, the plaintiffs' harm was not proximately related to the U.S. cartel-related harm, and the lower courts dismissed the case on the remand—as they should have done and courts probably would have done pre-*Empagran* and pre-FTAIA (although not for lack of subject matter jurisdiction over the price-fixing).

## III. BACK TO BASICS

Why is it that the *Empagran* plaintiffs should be out of court and Motorola (especially for the 42 percent) should not be? Here, I want to present the framework for analysis pre-*Empagran*, even including post-FTAIA, regarding the reach of the Sherman Act (which until recently was called subject matter jurisdiction). The framework is based on the following goal regarding foreign-related offenses: We want to protect our citizens/residents/businesses from antitrust violations, from wherever launched, without interfering unreasonably with choices our trading partners make to regulate their own economies.

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[4] Compare the famous *Lotus* case, which formed the foundation for acceptance of the effects doctrine under international law: the negligent careening of a Turkish ship into a French ship on the high seas was equivalent to a bullet shot from one national territory into another. S.S. Lotus (France v. Turkey), 1927 P.C.I.J. (Permanent Court of International Justice).

[5] This is the statute that, defendants claim, made a revolutionary cut-back in the reach of the Sherman Act. It is the Foreign Trade Antitrust Improvements Act of 1982, Title IV of The Export Trading Company Act, 15 U.S.C.A. § 6a and § 45(a) (3). Title IV clarified that conduct that harms solely foreign markets is not caught by the Sherman Act or Federal Trade Commission Act. *See* text following n. 16 *infra*.

Why do we (Americans) want to avoid unreasonable interference with foreign sovereign choices? Both as part of a reciprocal compact—to protect our sovereignty when the tables are turned;—and to avoid action that will interfere with our foreign relations.

The framework is composed of two sets of questions:

1. Does the United States have a stake in reaching the impugned conduct?[6] (often stated in terms of effects on U.S. commerce). It clearly does if the conduct is price-fixing into the U.S. market. It clearly does not if the conduct is price-fixing abroad by foreigners who hurt foreigners and foreign market competition (the *Empagran* facts as presumed by the Supreme Court).

   The early cases after enactment of the FTAIA drove home the point—which was the reason for the legislation—that the Sherman Act does not follow American firms into foreign markets. The United States has no business regulating American business in foreign markets whose conduct does not impact U.S. markets. Such regulation is a handicap on U.S. firms and on U.S. competitiveness (the main point of the FTAIA). Thus, Pfizer's distribution system in Europe for the European market was not proscribed by the Sherman Act even if it would have been illegal if adopted in the United States.[7] The FTAIA overturned the handful of cases that violated this principle.[8]

2. If the United States has a legitimate stake in enforcement, we reach the comity questions: Are the links with, and interests of, involved foreign nations stronger than the links with and interests of the United States? If so, the Sherman Act does not reach the conduct.[9] The answer is virtually always no if the United States has a significant stake and thus an antitrust interest to exonerate.[10]

Even if the United States has a legitimate stake in regulating the conduct, and even if there is no foreign sovereign claim of such weight that it would trump the Sherman Act, various defenses would be available. Thus, in *Empagran*, if the case was not dismissed under question 1 for lack of jurisdiction over the subject matter of the claim, the case would probably be dismissed because plaintiffs' injury was not proximately caused by conduct related to the U.S. cause of action.[11] The foreign plaintiffs would have had no standing to sue the foreign defendants under the Sherman Act.[12]

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[6] *See* Eleanor Fox, *Extraterritoriality, Antitrust, and the New Restatement: Is Reasonableness the Answer?*, 19 NYU J. INT'L L. & POLITICS 565 (1987).

[7] Eurim-Pharm GmbH v. Pfizer, Inc., 593 F. Supp. 1102 (S.D.N.Y. 1984).

[8] *See* John F. Bruce & John C. Peirce, *Understanding the Export Trading Company Act and Using (Or Avoiding) Its Antitrust Exemptions*, 38 BUS. LAWYER 975, 987 (ABA May 1983).

[9] *See* Mannington Mills, Inc. v. Congoleum Corp., 595 F.2d 1287 (3d Cir. 1979); Timberlane Lumber Co. v. Bank of America, 549 F.2d 597 (9th Cir. 1976), applying a test that was in part jurisdictional and in part speaking to the discretion of the court.

[10] Fox, *supra* note 6 at 576-77.

[11] Compare Empagran S.A. v. F. Hoffmann-LaRoche Ltd., 417 F.3d 1267 (D.C. Cir. 2005), cert. denied, 546 U.S. 1092 (2006), asking whether the effect of the vitamin cartel in the United States proximately caused the foreign plaintiffs' injuries.

[12] This result was clarified by the FTAIA. See Bruce & Peirce, *supra* note 8 at 983 et seq.

Let us return to the first part of question 2. Was there a legitimate, weighty foreign sovereign counterweight in *Empagran*? First, there was nothing to countervail; the United States had no interest in hosting these suits by foreigners against foreigners for a foreign conspiracy that hurt foreign markets wholly independent from U.S. effects, so it would take nothing on the scale to require dismissal and next to nothing to tilt towards a pro-foreign balance of interests. But tellingly, in *Empagran*, none of the involved foreign sovereigns—Ukraine, Ecuador, Australia, and Panama—even came forward to express their views of interference or otherwise. Ecuador, which then had no antitrust law, would surely have been delighted for their nationals to have a vehicle to recover their losses. The nations on whose behalf amicus briefs were filed—including the United Kingdom, Germany, and Japan—expressed the concern that a U.S. enforcer-for-the-world would undermine establishment of their own private enforcement systems, and would also undermine their leniency programs by deterring whistleblowers, who would be immediately confronted with the damages they caused and for which they would all the more certainly have to pay—creating great liability for their firms, making them non-competitive.

Since the United States had no stake in exercising jurisdiction, it was an easy shot for the Supreme Court to nod to foreign concerns and disavow U.S. ambition to become antitrust enforcer for the world.

## IV. WHOSE EXTRATERRITORIALITY IS IT?

But where the United States *has* a significant stake in protecting its firms from price-fixing on inputs destined for the U.S. market, would these (somewhat orchestrated) foreign sovereign arguments amount to anything more than—We live in an increasingly interdependent world and enforcement by one nation has ripples across the seas? In cases of real U.S. stakes, as in *Motorola*, the claim of "extraterritoriality" has lost its ring. Whose extraterritoriality is it? That of the United States, which seeks to protect its citizens/residents from the culprits, wherever they might be? Or that of the culprits' home nation, which, by insulating its firms if it can from the consequences of their out-bound-directed conduct (which is illegal at home and abroad),[13] puts costs on the harmed nation, its businesses, and in consequence the citizens of the world? The insight of the Coase theorem is relevant: cause is reciprocal.[14] Does U.S. law cause AU Optronics and Taiwan harm, or does AU Optronics and Taiwan cause the United States (and the world) harm?

The fact is, not only would enforcement of the Sherman Act against input cartels in global chains intuitively not interfere with U.S. foreign relations, but the United States has filed an amicus brief in *Motorola* to say so[15] and to sound the alarm that the cut-back urged by defendants and endorsed by the district court and the first (now vacated) opinion of the Court of

[13] There is no claim that the United States, by applying its anticartel law, interferes with Taiwan's prerogative to regulate its own economy. This is a far cry from the days of *Alcoa* when trading partners could claim that the United States was an outlier in prohibiting cartels and they had made a different regulatory choice. It bears noting that even where cartelists' home nations make a different regulatory choice, the offending firms are not automatically excused for their outbound cartel that violates the law of the importing country. Hartford Fire Ins. Co. v. California, 509 U.S. 764 (1993).

[14] *See* Ronald H. Coase, *The Problem of Social Cost*, 3 J. L. & ECON. 1 (1960).

[15] *See* Supplemental Brief for the United States as Amicus Curiae, Motorola Mobility LLC v. AU Optronics Corp., Court of Appeals for the Seventh Circuit, June 27, 2014.

Appeals for the Seventh Circuit threatens to deeply undermine the U.S. federal imperative to reach offshore cartels that hurt the United States.[16]

## V. THE FTAIA AND WHAT IT MEANT TO DO

The FTAIA was not a foreign cartelists' benefit act. In fact, it was meant to help American business. As Chairman Peter Rodino, co-sponsor of the legislation, said as he opened hearings before the House of Representatives Subcommittee on Monopolies and Commercial Law of the Committee on the Judiciary on March 26, 1981:

> H.R. 2326 [the FTAIA] would amend the Sherman Act and the Clayton Act to remove . . . any unnecessary barriers to export trading by U.S. firms. At the same time, it would continue to provide antitrust protection for American consumers and competitors.[17]

Shortly after the legislation's passage, an American Bar Association journal published a thorough analysis of the legislation, its history, and intended effects. The article echoes Chairman Rodino's statement:

> The main purpose of the title IV amendments [i.e., the FTAIA] is to codify the jurisdictional reach of the Sherman and FTC Acts. As the House Judiciary Committee put it, the objective of the amendments is "freeing American-owned firms that operate entirely abroad or in United States export trade from the possibility of dual and conflicting antitrust regulation." Where conduct by foreigners in foreign countries is concerned, these amendments may clarify the law, but do not appreciably change it.[18]

The main advocates for the legislation were small and middle-sized exporters and their champion, U.S. Secretary of Commerce Malcolm Baldrige, who was the first witness at the hearings and who was concerned about loss of competitiveness of American business. The exporters feared application of the Sherman Act to their export associations. They worried that U.S. law would follow them in foreign commerce, and they wanted clarity that it would not. Two bills were introduced into Congress; one in the House of Representative and one in the Senate, and there ensued a sort of race.

The Senate bill got there first. This bill was regulatory. It provided for a process for a certificate of review for exporters who filed with the Commerce Department and the FTC and whose proposed conduct or association was not anticompetitive or unfair as to the United States.

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[16] The fears of the U.S. Solicitor General have been confirmed. AU Optronics and two of its executives have filed petitions with a view towards setting aside their criminal convictions for price fixing the LCD panels. They seek a rehearing before the full Court of Appeals for the Ninth Circuit, questioning among other things the applicability of the Sherman Act to their (foreign) conduct in view of the FTAIA.

[17] Hearings Before the Subcommittee on Monopolies and Commercial Law of the Committee on the Judiciary House of Representatives, 97th Cong. 1st Session on H.R. 2326, Foreign Trade Antitrust Improvements Act, p. 1. (March 26, 1981). The bill was also meant to clarify the law by making clear that the Sherman Act does not reach harm that infects solely foreign markets. As I testified at the opening hearing on the Rodino bill:

> The bill, as I understand it, is intended to make two things clear: First, that the U.S. antitrust laws do not protect foreign consumers against breakdown of competitive conditions in foreign countries; and, two, the U.S. antitrust laws do not protect foreign producers against loss of competitive opportunities in foreign countries. *Id*., p. 27.

[18] Bruce & Peirce, *supra* note 8 at 980.

By rights, this legislation should have replaced the Webb Pomerene Act, which gives exporters who file with the FTC immunity from U.S. antitrust for harms abroad, but the existing Webb Pomerene associations objected to a sunset because they drew comfort from the strong Webb-Pomerene name.

The other bill became what we now know as the FTAIA. It was designed to clarify the reach and limits of the Sherman Act, particularly to remove the chill on U.S. exporters, but without new bureaucracy. It made clear that the Sherman Act does not cover export associations and other restraints as long as they harm only foreign markets. It was intended to protect the interests of Americans; clearly not to make them impotent to defend their interests when exploited by foreign cartels.

After the export-certificating bill was passed, there was a question whether the House Bill was any longer necessary; but its sponsor, Peter Rodino, was committed to the non-regulatory solution and ushered his bill through the House.[19] Both bills passed the Congress, and both are titles in the Export Trading Company Act of 1982. The certificating bill is Title III. The non-regulatory solution (the FTAIA) is Title IV.

## VI. WHERE *EMPAGRAN* WENT WRONG (ALTHOUGH IT WAS HARMLESS ERROR IN *EMPAGRAN*)

The Supreme Court disposed of the *Empagran* case by an interpretation of paragraph (2) of the FTAIA. Paragraph (2) must be read in the context of both paragraphs (1) and (2). The statute provides that, for commerce other than import commerce, (1) the Sherman Act shall not apply to conduct involving commerce with foreign nations unless "such conduct has a direct, substantial, and reasonably foreseeable effect" on import trade or commerce or the export trade of a person engaged in such trade in the United States, and "(2) such effect gives rise to a claim under the provisions of [the Sherman Act or FTC Act §5 (a)], other than this section."[20]

The Supreme Court in *Empagran* viewed the FTAIA as sweeping all conduct involving foreign commerce (other than imports) out of the reach of the Sherman Act, and then drawing back only the confined class that fits within paragraphs (1) and (2). Thus, Sherman Act coverage of conduct involving foreign commerce would be an exception to the rule. Second, the Court focused on paragraph (2).

Under paragraph (2), the "direct, substantial and reasonably foreseeable effect" of the conduct on U.S. domestic or export commerce must "give[ ] rise to a claim" under Section 1 or 2 of the Sherman Act or Section 5 (a) (1) of the Federal Trade Commission Act. For a cartel having the effect of raising prices in the United States, the effect must (and would) give rise to a violation of Section 1 of the Sherman Act. But suppose an export joint venture of small firms excludes another firm, and the jilted firm cries "boycott!" Or suppose an export joint venture creates

[19] *See* Bruce & Peirce, supra note 8 at 977-78; Fox, *supra* note 6 at 577-79.

[20] Section 5 (a) (1) of the Federal Trade Commission Act prohibits "unfair methods of competition in or affecting commerce . . . ." The FTAIA adds subsection 3 to Section 5 (a) of the FTC Act. Subsection (3) (B) requires: "such effect gives rise to a claim under the provisions of this subsection, other than this paragraph."

efficiencies and destroys an inefficient competitor.[21] Is there "an effect" on U.S. commerce? Yes; but not an anticompetitive effect. As explained by Bruce and Peirce:

> The effect conferring jurisdiction . . . must "giv[e] rise to a claim" under the provisions of the Sherman or FTC Acts. The House Judiciary Committee was most concerned that *beneficial* effects on U.S. interstate commerce—for example, an increase in profitability or employment—should not create antitrust jurisdiction.[22]

In *Empagran*, the Supreme Court misconstrued the plain meaning of paragraph (2). It changed the word "a" claim to "the" claim; that is "the [plaintiff's] claim." It then said that the off-shore cartel's U.S. effect (price rise of vitamins in the United States) did not give rise to the Ecuadorians' and Ukrainians' having to pay an overcharge on the vitamins they bought abroad, and therefore their case failed to meet the requirements of paragraph (2) and was not covered by the Sherman Act.

This was a big error of construction. The *effect* of a violation in the United States never gives rise to a reasonably proximate antitrust injury to a foreigner. When, for example, the Wildenstein Art Gallery, as a result of the Christie-Sotheby trans-Atlantic price fix, paid an overcharge on a Rembrandt that it bought at Sotheby's in London, it was injured by the conspiracy, not by the overcharge of paintings in New York.[23]

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[21] Since the FTAIA retained subject matter jurisdiction in the case of harm to the export business of an exporter from the United States, it was especially important to clarify that the FTAIA itself did not create a cause of action; the exporter—and any other Sherman Act plaintiff—must be able to state a cause of action based on Sherman Act, §§ 1 or 2, and the FTC must be able to make out a cause of action under Subsection 5 (a) (1) of the FTC Act.

[22] *Id.* at 986 (footnotes omitted). *See* also Brief of Amici Curiae Legal Scholars (Professors Harry First & Eleanor Fox) in Support of Respondents, F. Hoffmann-LaRoche Ltd. v. Empagran, S.A., No. 03-724, pp. 5-10.

[23] These are only two of the seven interpretative reasons or factors that demonstrate the Court's error in reading "a claim" as "the plaintiffs' claim." The seven are:

1. The language of the statute is clear in the relevant respect.
2. The Court's construction creates a null category.
3. The statute clearly concerns jurisdiction over the subject matter of the action; it does not relate to who sues to challenge the conduct. The words "subject matter jurisdiction" are repeated throughout the legislative history.
4. The title (FTAIA) is a title of the Export Trading Company Act. The statute is about export trading and competitiveness.
5. Congress understood that the FTAIA of 1982 did nothing to help foreign firms escape from Sherman Act liability if their conduct had a significant effect on U.S. commerce. Three years later, Senator Dennis DeConcini introduced the Foreign Trade Antitrust Improvements Act of 1985—a bill that never passed. *This* bill was designed to respond to complaints of foreign firms about private actions against them. It would have facilitated early dismissal of such private actions on grounds of lack of subject matter jurisdiction. *See* Hearings Before the Committee on the Judiciary United States Senate, 99th Cong. 1st Session on S. 397, to Amend the Sherman Act and the Clayton Act to Modify the Application of Such Acts to International Commerce (June 21 and October 15, 1985).
6. To the best of my knowledge, all of the interpretations following adoption of the FTAIA, and for two decades thereafter until *Empagran,* gave the language its plain meaning. The consensus understanding immediately after a law is passed would seem to be more credible than a (revolutionary) construction 20 years later.

The construction was harmless error on the *Empagran* facts because the plight of the Ecuadorians and Ukrainians had no reasonable connection with the U.S. violation. But it was a bomb waiting to explode in a case such as Motorola's.

## VII. HOW TO CORRECT THE ERROR

There were two errors of the Court in *Empagran*; one general and one specific. The first was identifying a foundational perspective of inhospitality, by reason of the FTAIA, to the Sherman Act's reach of foreign-related conduct. The second is the re-writing of paragraph (2) to replace "a claim" with "the claim"—i.e., the plaintiff's claim.

I shall first say a word about the specific error: the wrong construction of "gives rise to a claim." How can the harm be ameliorated? Courts should limit the *Empagran* interpretation of paragraph (2) to facts such as in *Empagran* where on the face of the matter the connection with U.S. commerce is attenuated. In all other cases, courts should recognize that the *Empagran* construction nullifies the foreign commerce reach of the Sherman Act except in the diminishing set of cases of direct imports of price-fixed goods[24]—the category expressly outside of the operation of the FTAIA.

Had the *Motorola* facts come to the Supreme Court before the *Empagran* facts, the Court may well have avoided its erroneous construction of paragraph (2) because it would then have been forced to confront the consequences of the construction as applied to a legitimate Sherman Act case by an American firm designedly harmed by an off-shore cartel. Courts can satisfy the spirit of the Supreme Court's construction of paragraph (2) by requiring that the plaintiff's cause of action be proximately related to the effect of the impugned conduct on U.S. commerce.

The general error is the Supreme Court's perspective on the FTAIA. The Court wrongly detected, or more accurately injected, a Congressional stance of hostility to Sherman Act coverage of foreign acts. There clearly was none, especially when it comes to exposing U.S. firms to antitrust harms. The general stance of hostility threatens to skew the interpretation of the requirement of "direct, substantial, and reasonably foreseeable effects" on U.S. commerce.

I propose that courts should not extend the stance of inhospitality to claims by Americans injured by acts destined to affect the U.S. marketplace. "Direct, substantial and reasonably foreseeable" merits a flexible interpretation sympathetic to the protections of antitrust. It is properly treated, as it was before *Empagran*, as an iterative phrase.[25] The more foreseeable is a harm, the less direct must be the line between cause and effect, as in the application of proximate cause in torts.[26] Thus, the contextual interpretation of "direct" in the Seventh Circuit's decision

7. The Court's construction, by focusing on the particular private plaintiffs' Sherman Act claims, ignores the parallel language amending the FTC Act. There is no private right of action under the FTC Act. Therefore the same words in the parallel FTC amendment would do no work.

[24] Diminishing because of the growth of global value chains and because price-fixers are generally too smart to sell their rogue goods directly into the United States. *See* Minn-Chem, Inc. v. Agrium, Inc., 683 F.3d 845 (7th Cir. 2012).

[25] *See* Mannington Mills, *supra* note 9; Timberlane, *supra* note 9; U.S. Department of Justice and FTC Antitrust Enforcement Guidelines for International Operations (April 1995) at 3.121.

[26] *See*, e.g., Marshall v. Nugent, 222 F.2d 604 (1st Cir. 1955).

*Minn-Chem*[27] and the Second Circuit's decision in *Lotes*[28]is much more faithful to the law than is the de-contextualized interpretation of "direct" in the district court and vacated court of appeals decisions in *Motorola*.

## VIII. CONCLUSION

U.S. law is in danger of creating a void in the reach of U.S. antitrust law to reprehend anticompetitive acts by foreigners abroad destined to raise the price of goods and services to U.S. consumers. *Motorola*, the input-cartel global-value-chain case, which will be reheard by the panel of the Court of Appeals for the Seventh Circuit to which it was originally assigned, is a test case. It is no wonder that, in its first and now vacated decision, the panel was misled by the *Empagran* Court's failure to appreciate the pedigree of the FTAIA. The Seventh Circuit court now has the opportunity to move the law in a direction that carries out the Congressional mandate and meets the needs and economic circumstances of the 21st century.

[27] *Supra* note 24.

[28] Lotes Co. v. Hon Hai Precision Indus. Co., 753 F.3d 395 (2d Cir. 2014).

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## Comity, Domestic Injury, and the Metaphysics of the FTAIA

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# Comity, Domestic Injury, and the Metaphysics of the FTAIA

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## I. INTRODUCTION

In the early 1960s, the British philosopher Richard Taylor famously argued that he could use well-accepted principles of logical reasoning to prove the doctrine of fatalism—the idea that mankind lacks free will and life's outcomes are pre-determined. A fatalist, explained Taylor, perceives that a person's actions in the present do not determine outcomes in the future any more than a person's actions in the present determine outcomes in the past. To illustrate, Taylor used the example of a man sitting down to breakfast with his morning newspaper, where conditions are such that if a naval battle occurred yesterday, the newspaper will carry a specific headline today, and if a naval battle did not occur yesterday, the paper will carry a different headline today. Everyone understands that the man does not determine whether the naval battle occurred yesterday by opening his newspaper and *seeing* one headline or the other today. In Taylor's words, "we all are fatalists with respect to the past."[2]

Taylor then asked readers to consider a boat at sea, where conditions are such that if the boat captain gives one order, a naval battle will occur, and if the boat captain gives a different order, a naval battle will not occur. The fatalist, explained Taylor, uses the same logical principles to conclude that what kind of order the boat captain gives depends on *whether a naval battle will take place*; it is not determined by the boat captain.[3] Taylor's essay exasperated some of his fellow philosophers for decades, not because it persuaded them of fatalism's merits, but because they couldn't adequately refute Taylor's logic. Others doubtless rolled their eyes and simply asked, "why should we care?"

Fast forward a half century, and Motorola Mobility is entangled in a messy international antitrust dispute with a global price-fixing cartel that, at first blush, may seem like it has nothing whatever to do with Richard Taylor's logical argument for fatalism. As of this writing, after a grueling and erratic traverse through the federal courts, Motorola's Sherman Act claim against foreign manufacturers of LCD panels used in Motorola smart phones is now on interlocutory appeal in the Seventh Circuit. The parties and amici are arguing primarily about the proper interpretation of statutory language in the Foreign Trade Antitrust Improvements Act of 1982 ("FTAIA"), an act of Congress that delineates the metes and bounds of the Sherman Act's

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[1] Randy M. Stutz is Senior Counsel & Director of Special Projects at the American Antitrust Institute (AAI). *See* http://www.antitrustinstitute.org. The AAI submitted amicus briefs in several of the cases identified in this article, including *Empagran* and *Motorola*. *See* http://www.antitrustinstitute.org/aai_activities/amicus-program. The author wishes to thank Rick Brunell, AAI's General Counsel, who co-authored the AAI brief in *Motorola* with Mr. Stutz, and who contributed original thinking to some of the ideas reflected in this article. The views expressed are the author's alone and do not necessarily reflect the views of AAI.

[2] *See* Richard Taylor, *Fatalism*, 71 PHIL. REV. 1 (1962), *reprinted in* FATE, TIME, AND LANGUAGE 41-51, 45 (Steven M. Cahn & Maureen Eckert eds., 2011).

[3] *See id*. at 46-47.

extraterritorial application. This battle for the meaning of the FTAIA's language raises a philosophical question similar to the one raised by Taylor's argument: Why should we care what sound logic can prove about the direction of causation?

## II. BALANCING COMITY PRINCIPLES AGAINST THE GOALS OF THE U.S. ANTITRUST LAWS

The FTAIA prevents Sherman Act suits in U.S. courts where anticompetitive conduct causes foreign injury, excluding conduct involving domestic or import commerce and excepting otherwise foreign conduct that has certain kinds of domestic effects. Ostensibly, the FTAIA was passed to confirm for American exporters and multinationals that the Sherman Act does not prevent them from entering into anticompetitive business arrangements that adversely affect only foreign markets.[4] Although this formulation of the Act's purpose could be mistaken for encouraging American firms to injure foreign economies with impunity, the Supreme Court has made clear that the FTAIA is borne of regard, not disregard, for foreign nations.

In *Empagran*, the Court explained that principles of prescriptive comity are fundamental to the FTAIA's partial prohibition on the extraterritorial application of the Sherman Act. As Justice Scalia explained in detail in his *Hartford Fire* dissent, cited approvingly by the majority in *Empagran*, prescriptive comity can be defined as "the respect sovereign nations afford each other by limiting the reach of their laws."[5] Its principal dictate is that courts should construe ambiguous statutes so as not to permit them to interfere with the sovereign authority of foreign nations unreasonably.[6]

At the same time, the *Empagran* Court noted that "our courts have long held that application of our antitrust laws to foreign anticompetitive conduct is nonetheless reasonable, and hence consistent with principles of prescriptive comity, insofar as they reflect a legislative effort to redress *domestic* antitrust injury that foreign anticompetitive conduct has caused."[7] The *Empagran* Court thus neatly framed the fundamental underlying FTAIA policy inquiry as whether extraterritorial application of the Sherman Act would unreasonably "interfere with a foreign nation's ability independently to regulate its own commercial affairs," or if it instead would be consistent with Congress' "legislative effort to redress domestic antitrust injury that foreign anticompetitive conduct has caused."[8]

*Empagran* involved the "domestic effects" exception of the FTAIA, which permits plaintiffs to sue in U.S. court where conduct causes foreign injury, but the conduct also has a direct, substantial, and reasonably foreseeable domestic effect and that effect "give[s] rise to a [Sherman Act] claim."[9] The plaintiffs were foreign companies that purchased vitamins overseas from the infamous vitamins cartel, which raised vitamin prices worldwide. They had suffered

[4] *See* H.R. Rep. No. 97-686, pp 1-3, 9-10 (1982).

[5] *Hartford Fire Ins. Co. v. Cal.*, 509 U.S. 764, 817 (1993) (Scalia, J., dissenting).

[6] *Id.* at 818-19 (citing Restatement (Third) § 403(1)).

[7] *F. Hoffman-LaRoche Ltd., v. Empagran S.A.*, 542 U.S. 155, 165 (2004) (citing *United States v. Aluminum Co. of America*, 148 F.2d 416, 443-444 (CA2 1945) (L. Hand, J.); P. AREEDA & D. TURNER, ANTITRUST LAW, 236 (1978)) (emphasis in original).

[8] *Id.* at 165.

[9] *Id.* at 161-62.

foreign harm caused by foreign conduct, but they claimed a right to sue in U.S. court under the FTAIA because that conduct also had a harmful domestic effect on U.S. vitamin prices, and that effect gave rise at least to "a" Sherman Act claim. They reasoned that, if nothing else, the domestic effect gave rise to a claim by American purchasers who bought vitamins in the United States. Justice Breyer, writing for the majority, framed the essential question in balancing comity principles and domestic redress goals to determine whether the FTAIA permits suits like this one. He asked:

> Why is it reasonable to apply [the antitrust] laws to foreign conduct insofar as that conduct causes independent foreign harm and that foreign harm alone gives rise to the plaintiff's claim?[10]

## III. THE DIRECTION OF CAUSATION

The majority could find "no good answer to the question,"[11] and it held that the plaintiffs could not demonstrate that a domestic anticompetitive effect gave rise to "a claim" as required by the second prong of the FTAIA's domestic effects exception. The Court reached this outcome by declaring that the second prong of the exception requires that the domestic effect give rise to not just "a" claim, but rather to *the plaintiff's claim at issue*.

The Court did take pains to emphasize, however, that its holding was limited to circumstances where a plaintiff claimed injury arising out of conduct that caused independent foreign harm. It indicated that where "the foreign injury was inextricably bound up" with the domestic effect, or "the domestic harm depended in part upon the foreign injury," the result might be different.[12]

On remand, the D.C. Circuit was left to apply the Court's holding to one of the plaintiffs' surviving arguments, which was that its injury from foreign harm was not in fact "independent" of the domestic effect, because the defendants had to inflate prices in the United States (and globally) to successfully inflate prices in any one jurisdiction. Otherwise, the plaintiffs argued, arbitrage would have successfully defeated the price increase.

In a short opinion, the D.C. Circuit rejected the plaintiffs' argument by putting still another new gloss on the statutory language. Reiterating the comity concerns associated with allowing a foreign plaintiff to recover in U.S. court for foreign harm that was independent of a harmful domestic effect, the court held that the "gives rise to" prong requires a relationship of proximate cause between the domestic effect and the plaintiffs' claimed injury. Although the plaintiffs could establish but-for cause, the court held that they could not establish proximate cause. Importantly, the D.C. Circuit explicitly based its decision to institute a proximate cause standard for the "gives rise to" prong on the same prescriptive comity principles identified by the Supreme Court in *Empagran* and in Justice Scalia's *Hartford Fire* dissent.[13]

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[10] *Id*. at 165.

[11] *Id*.

[12] *Id*. at 171-72 (discussing *Industria Siciliana Asfalit, Biutmi, S.p.A. v. Exxon Research & Engineering Co.*, No. 75 Civ. 5828 CSH, 1977 U.S. Dist. LEXIS 17851 (S.D.N.Y. Jan. 18, 1977) and *Dominicus American Bohio v. Gulf & Western Industries, Inc.*, 473 F. Supp. 680 (S.D.N.Y 1979)).

[13] *Empagran S.A. v. F. Hoffmann-Laroche*, 417 F.3d 1267, 1271 (D.C. Cir. 2005) (citing *Hartford Fire*, 509 U.S. at 817; *Empagran*, 124 S. Ct. at 2366).

The D.C. Circuit's use of a proximate cause standard took for granted the direction of causation in *Empagran*. Implicitly, the proximate cause inquiry into the relationship between the domestic effect and the plaintiff's claimed injury in *Empagran* presupposed a specific temporal relationship between the domestic effect and the claimed injury. Namely, the domestic effect had to precede the claimed injury in time. Logically, a claimed injury can never precede a domestic effect if the effect is to have proximately caused the claimed injury, because an effect never precedes its cause.

## IV. SHOULD THE DIRECTION OF CAUSATION FORECLOSE SHERMAN ACT CLAIMS?

The D.C. Circuit's holding on remand in *Empagran* filled a gap that the Supreme Court had left open where foreign plaintiffs might seek to recover in U.S. court for foreign harm that is independent of domestic harm. However, the court did not disturb the Supreme Court's holding with respect to domestic harm that is *dependent* on foreign harm. The Supreme Court unmistakably confirmed that this kind of foreign harm can satisfy the "gives rise to" prong of the domestic effects exception, notwithstanding that the temporal relationship between claimed injury and domestic effect is reversed. First, the Court had allowed that the prong could be satisfied where the "foreign injury was inextricably bound up" with the domestic effect. This statement is at most agnostic about the temporal relationship between domestic effect and claimed injury.

More importantly, however, the Court had allowed that the prong could be satisfied where "the domestic harm *depended* in part upon the foreign injury."[14] Logically, a claimed injury must *precede* a domestic effect if the domestic effect is to *depend* on the claimed injury, because, with all due respect to fatalists, an effect cannot depend on something that has not yet occurred.

Recently, the D.C Circuit's holding on remand in *Empagran* seemed to confuse the Second Circuit in *Lotes v. Hon-Hai Precision Industry Co.*,[15] and that confusion could play an important role in the *Motorola* case. Both *Lotes* and *Motorola* involve instances in which anticompetitive conduct targets foreign component goods that are inserted overseas into end-products bound for the United States. The conduct in both cases is part of a proliferating international trend—of proliferating concern to the DOJ's Antitrust Division—involving international cartels targeting the so-called "component-goods" sector.

Component-goods manufacturers make products that serve as component parts of other goods. They are a staple of the modern global supply chain, particularly for complex electronics products. Companies often will independently source components of complex products globally, and then assemble the finished end-product overseas before importing it into the United States. When foreign component-goods manufacturers artificially inflate the price of component goods in these circumstances, whether by price-fixing or otherwise, U.S. consumers inevitably are injured, often severely, with harm frequently in the billions of dollars.[16] Importantly for purposes

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[14] *Empagran*, 542 U.S. at 72 (emphasis added).

[15] 753 F.3d 395 (2d Cir. 2014).

[16] *See* Brief of the American Antitrust Institute in Support of Appellant at 2-5, Motorola Mobility LLC v. AU Optronics Corp., No. 14-8003, Doc. __ (7th Cir. Apr. 24, 2014) (discussing inadequate deterrence of intermediate

of interpreting the FTAIA in these circumstances, a victim's claimed injury in the price of the component good will inevitably precede the domestic effect caused by the inflated price of the end-product.

In *Lotes*, the Second Circuit adopted the D.C. Circuit's proximate cause standard for the second prong of the domestic effects exception, but without realizing that it has no meaningful application in the component-goods context, where domestic harm is *dependent* on foreign harm. The plaintiff in *Lotes* was a manufacturer of computer components called USB 3.0 connectors. The plaintiff alleged that a rival component manufacturer's foreign anticompetitive conduct (in China) raised the price of the components, which had the domestic effect of raising the price of the end-product computers for U.S. consumers.

The Second Circuit found the requisite direct, substantial, and reasonably foreseeable domestic effect, and it read the statutory language "gives to a claim" to mean "gives rise to the plaintiff's claim at issue." However, unlike the D.C. Circuit on remand in *Empagran*, which, along with the Eighth[17] and Ninth[18] Circuits, had used a proximate cause standard to determine whether the plaintiff's claim arose from independent foreign harm, the *Lotes* court determined that the plaintiff's claim arose from independent foreign harm *because* it used a proximate cause standard.

*Lotes* was not like *Empagran*, where the domestic effect and the claimed foreign injury had an insufficient causal nexus, which led the Supreme Court to characterize the plaintiffs' claim for *succeeding*, rather than *preceding*, foreign harm as a claim for "independent foreign harm." In *Lotes*, the domestic effect (inflated computer prices) was *dependent* on the claimed foreign injury (inflated USB 3.0 connector prices). Because the *Lotes* court applied a proximate cause standard where the domestic injury was *dependent* on the claimed foreign harm, it very easily concluded that the plaintiff's claim could not go forward. The court's conclusion, however, was a tautology. If the "test" is whether foreign harm that *precedes* a domestic effect proximately causes that effect, there can only be one answer. An effect never precedes its cause. In reality, the *Lotes* court did not base its decision on anything having to do with proximity; it based its decision on the direction of causation between the domestic effect and the foreign injury.

In *Motorola*, the plaintiff is not a rival manufacturer, as in *Lotes*, but rather a purchaser. The defendants are members of a global cartel that manufactures LCD panels that are used in Motorola's smart phones. Motorola alleges that the cartel's price-fixing raised the price of LCD panels, which had the domestic effect of raising the price of smart phones for U.S. consumers. The defendants in *Motorol*a make the same argument made in *Lotes*, using the same reasoning. In briefs filed during earlier proceedings, the defendants cite to *Lotes* and argue that "any suggestion that higher cellphone prices give rise to claims of higher panel prices has things backwards. Higher panel prices allegedly gave rise to higher cellphone prices, not vice versa."[19]

goods cartels), *available at* http://www.antitrustinstitute.org/content/aai-asks-seventh-circuit-reject-immunity-international-cartels-harm-us-victims-motorola-v-au.

[17] *See In re Monosodium Glutamate Antitrust Litig.*, 477 F.3d 535, 538 (8th Cir. 2007).

[18] *See In re Dynamic Random Access Memory (DRAM) Antitrust Litig.*, 546 F.3d 981 (9th Cir. 2008).

[19] *See* Resp. to Pet'n for Rehearing at 5-7, Motorola Mobility LLC v. AU Optronics Corp., No. 14-8003, Doc. 37 (7th Cir. 2014).

Although the defendants have not (yet) expressly asked the court to follow *Lotes* in applying a proximate cause standard where the domestic injury was *dependent* on the claimed foreign harm, they essentially argue that the claimed foreign injury should be disqualified because it precedes the domestic effect temporally.

Considering what is at stake in the component-goods sector, where global cartels seem to be growing in tandem alongside global supply chains for U.S. bound end-products, causing tremendous harm to U.S. consumers, there is no discernible policy justification or sensible reason to eliminate Sherman Act claims based on the direction of causation.[20]

The D.C. Circuit emphasized that it relied entirely on comity considerations in reading the second prong of the exception to incorporate a proximate cause test on the *Empagran* facts. It noted that a more flexible standard might "interfer[e] with other nations' prerogative to safeguard their own citizens from anti-competitive activity within their own borders."[21] Eliminating Sherman Act claims arguably makes some sense where conduct causes independent foreign harm, and that harm alone gives rise to the plaintiff's claim. In that circumstance, comparatively little is lost with regard to domestic redress goals. But to apply a proximate cause "test" where the domestic effect is *dependent* on claimed foreign harm makes no sense, unless *every* sensible balancing of comity principles and domestic redress goals would to suggest that Sherman Act claims should *never* be permitted, no matter how severe the domestic injury.

In reality, foreclosing Sherman Act recoveries under the domestic effects exception whenever a foreign injury precedes the domestic effect can lead to perverse results, particularly in the component-goods context. Consider, for example, that in the United States, *Illinois Brick* prevents indirect purchasers from recovering damages. Yet many foreign jurisdictions, while moving slowly toward permitting private remedies for antitrust violations, do not have *Illinois Brick's* corollary, *Hanover Shoe,* which prevents defendants from asserting "pass on" as a defense.[22]

Consequently, in the component-goods context, *Illinois Brick* prevents an injured U.S. purchaser from recovering for the inflated price of the end-product because the U.S. victim is an indirect purchaser of the component good. And yet a foreign direct purchaser of the component good, if it passed on the overcharge to U.S. consumers, would have no claim abroad because the defendant would have a pass-on defense. Perversely, then, in those jurisdictions, the more that foreign harm is absorbed by American indirect purchasers through pass-on, the less foreign cartelists will be deterred and punished by the Sherman Act, and the less victims will be compensated. And if the full 100 percent of the overcharge is passed on to American indirect purchasers, there would be no deterrence, punishment, or compensation from private

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[20] One might argue that the statutory language "gives rise to" requires that causation run in a single direction from domestic effect to injury, but a domestic effect caused by a proceeding injury can "give rise to" a claim in the sense that the preceding injury *creates* the necessary domestic effect. Moreover, the Supreme Court has already re-interpreted the statutory language to change the meaning of "a claim" in order to successfully balance comity and domestic redress goals. It would be anomalous not to do the same here if it were necessary to achieve the same balance.

[21] *Empagran*, 417 F.3d, at 1271.

[22] *See Illinois Brick Co. v. Illinois*, 431 U.S. 720 (1977); *Hanover Shoe, Inc. v. United Shoe Machinery Corp.*, 392 U.S. 481 (1968).

enforcement whatsoever, whether at home or abroad.[23] At the same time, because only Americans would be injured after 100 percent pass on, and no citizens of the foreign jurisdiction would be injured, no principle of prescriptive comity would be served either.

The Justice Department in its most recent *Motorola* filing has suggested that the causal direction does matter, as it had urged in *Lotes*, but that an exception to *Illinois Brick* should be considered for U.S. indirect purchasers when the direct purchaser abroad cannot satisfy the second prong of the FTAIA.[24] Assuming the Seventh Circuit buys such an exception, this solution is less than ideal from a deterrence point of view unless indirect purchasers are allowed to recover the entire amount of the overcharge, as the AAI pointed out in its brief.[25]

## V. WHAT WILL FATE DECIDE?

In *Motorola*, the Seventh Circuit will have to decide for itself whether the temporal relationship between injury and domestic effect, and the direction of the causal chain, have any real usefulness in answering the fundamental *Empagran* question of whether extraterritorial application of the Sherman Act would unreasonably "interfere with a foreign nation's ability independently to regulate its own commercial affairs," or if it, instead, would be consistent with Congress' "legislative effort to redress domestic antitrust injury that foreign anticompetitive conduct has caused."

One might respond by asking the same question deservedly put to Richard Taylor: Why should we care what sound logic can prove about the direction of causation? If the *Motorola* case makes it all the way to the Supreme Court, perhaps Justice Breyer will now ask:

> Why is it *unreasonable* to apply [the antitrust] laws to foreign conduct insofar as that conduct causes domestic harm that is *dependent* on the foreign harm that gives rise to the plaintiff's claim?

Where, as in *Motorola*, a U.S. victim wishes to sue in a U.S. court for injuries caused by foreign harm that preceded an otherwise qualifying domestic effect, the Court may have no good answer to the question.

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[23] Of course, deterrence from public enforcement would remain. However, current levels of combined deterrence from both public and private enforcement are already woefully inadequate, to the point that on average it is currently net profitable for international cartels to target Americans even if they are caught. *See* Brief of the American Antitrust Institute, *supra* note 16, at 2-5. Eliminating private enforcement would create a huge incentive for foreign cartels to further injure U.S. consumers by drastically increasing the profitability and reducing the risk of doing so.

[24] Brief for the United States and Federal Trade Commission in Support of Neither Party at 6, 20-24, Motorola Mobility LLC v. AU Optronics Corp., No. 14-8003, Doc. __ (7th Cir. Sept. 5, 2014), *available at* http://www.justice.gov/ atr/cases/f308400/308451.pdf.

[25] *See* Brief of the American Antitrust Institute in Support of Appellant at 3 n.2 , Motorola Mobility LLC v. AU Optronics Corp. (Sept. 5, 2014), *available at* http://www.antitrustinstitute.org/sites/default/files/ Motorola%20-%20As%20filed%20AAI%20Merits%20brief.pdf. The Seventh Circuit, without explanation, denied the AAI's unopposed motion to file this amicus brief, as well as an amicus brief submitted by several prominent economists. Both groups were permitted to submit briefs earlier in the proceedings. *See supra* note 16.

COMPETITION POLICY INTERNATIONAL

# CPI Antitrust Chronicle

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# Deterrence and Efficiency Considerations Warrant an Expansive Reading of the FTAIA

David Barth

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# Deterrence and Efficiency Considerations Warrant an Expansive Reading of the FTAIA

David Barth[1]

## I. INTRODUCTION

The Foreign Trade Antitrust Improvement Act of 1982 ("FTAIA") is an area of antitrust law in which courts' rulings have been unpredictable. Consider two recent cases in the Seventh Circuit: *Minn-Chem, Inc. v. Agrium, Inc.*, and *Motorola Mobility LLC v. AUO Optronics Corp.* In *Minn-Chem*, the District Court denied defendants' motion to dismiss on FTAIA–related grounds. Next, a three-judge appellate panel overturned that ruling and granted defendants' motion. Then, the Seventh Circuit sitting *en banc* affirmed the District Court's ruling and denied defendants' motion.

Similarly, in *Motorola*, the MDL court in the Ninth Circuit denied defendants' motion for summary judgment for certain categories of allegedly foreign purchases. When the case was remanded for trial, defendants moved for reconsideration. The District Court granted that motion and granted partial summary judgment for defendants, removing about 99 percent of Motorola's claimed purchases from the case. An appellate panel affirmed that ruling, but it did so with a decision that, according to the U.S. government, conflicts with the *en banc* decision in *Minn-Chem*.[2] After further developments in the case, the panel vacated its decision and accepted the appeal for argument on the merits.[3] So *Motorola* is once again before an appellate panel.

The vacated *Motorola* panel decision appears to have been an attempt to rule in a way that would add predictability to future cases involving the FTAIA. The decision set clear boundaries that would benefit defendants in future U.S. cases against international cartels.[4] Now that the decision has been vacated, there are a number of ways the panel could rule. I believe a ruling benefiting defendants and exempting any of Motorola's purchases from U.S. antitrust law before trial is undesirable as a matter of economic policy: It would increase the incentives foreign firms have to engage in cartel behavior in global markets, and it would create new incentives to change otherwise efficient supply chain behavior.

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[2] Brief for the United States and the Federal Trade Commission As Amici Curiae in Support of Panel Rehearing or Rehearing *En Banc*, 7 (April 24, 2014).

[3] The panel's ruling not only accepted the matter for appeal but also decided it on the merits absent any briefing on the merits. The procedural history of the case through early July is described in Petition For Hearing *En Banc* Of Motorola Mobility, LLC, 1-7 (July 9, 2014).

[4] Melissa Lipman, *7th Circ. FTAIA Ruling Curtails US Antitrust Reach*, LAW360 (April 1, 2014), and Alex Bourelly & Noah Mink, *7th Circ. Ruling May Restrict International Cartel Enforcement*, LAW360 (April 15, 2014).

## II. INTERNATIONAL CARTELS ARE INSUFFICIENTLY DETERRED

Hard-core, or secret, cartels are undesirable. The Organisation for Economic Co-operation and Development describes such cartels as "the most egregious violations of competition law."[5] The OECD also notes that such cartels are "are condemned in all competition laws."[6] The International Competition Network describes such cartels as "a direct assault on the principles of competition."[7] Both the OECD and the ICN say such cartels are "universally recognised as the most harmful of all types of anticompetitive conduct."[8] In one of its *Motorola* amicus briefs, the U.S. Government stated, "a global effort against hard core cartels, like the LCD price-fixing cartel, has emerged."[9]

Hence, potential cartels must be deterred from forming, or else cartels will continue to form and inflict harm on consumers.[10] Focusing on deterrence of potential cartels is appropriate because some cartels will manage to escape detection and punishment, making their secret illegal actions profitable after the fact. Cartels will be deterred from forming in the first place if the product of the probability of catching the cartel and the penalties if caught outweigh the anticipated financial benefits. If potential cartel members will not find it profitable to form a cartel, then they will not do so, and cartels will be effectively deterred.[11]

Deterrence is a difficult issue when considering global markets. For a cartel to effectively fix prices in a global market, it must raise prices worldwide. If it failed to raise U.S. prices, product would flow out of the United States to constrain the rise in non-U.S. prices.[12] This is notably an issue for cartels facing U.S.-based multinational buyers in a global market. U.S.-based multinational buyers have the information needed to resist attempts to increase non-U.S. prices relative to U.S. prices. Potential cartels facing this situation are likely to form and raise prices across the globe, including in the United States, or not form at all.

If non-U.S. competition authorities and legal systems fail to collectively impose adequate sanctions on international cartels operating in global markets, international cartels may decide to form and may operate profitably, even after considering the sanctions they expect to pay in the United States. The evidence shows this is more than a theoretical concern—actual sanctions are currently inadequate to deter the formation of international cartels. Connor studied 260 international cartels discovered between 1990 and mid-2005. While he reports the median U.S.

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[5] OECD, *Hard Core Cartels: Recommendation of the Council Concerning Effective Action Against Hard Core Cartels*, I (1998).

[6] OECD, *Fighting Hard Core Cartels: Harm, Effective Sanctions and Leniency Programmes*, 75 (2002).

[7] ICN, *Defining Hard Core Cartel Conduct, Effective Institutions, Effective Penalties*, 1 BUILDING BLOCKS FOR EFFECTIVE ANTI-CARTEL REGIMES, 1 (2005).

[8] OECD, *supra* note 6, at 75; ICN, *supra* note 7, at 1.

[9] Supplemental Brief for the United States as Amicus Curiae, at 6 (June 27, 2014).

[10] In the following, the shorthand "cartels" refers to hard-core, or secret, cartels.

[11] Other approaches can contribute to effective deterrence as well. Leniency programs, the threat of incarceration, and other approaches can create conflicting incentives among the cartelists and the individuals responsible for cartel activity. Cartels are unable to resolve these conflicting incentives via contracts, even when it would be jointly profitable to do so, as such contracts would be part of the cartel agreement, and hence illegal and unenforceable.

[12] The cartel might be able to raise non-U.S. prices by the amount of tariffs and transportation costs from the United States.

sanctions on such cartels exceed overcharges in the United States, the median ratio of total global sanctions to global overcharges was 42.3 percent among cartels that fixed prices on two or more continents.[13] More than half of detected global cartels kept more than 50 cents on every dollar of their overcharges, even after paying penalties. Eleanor Fox is right to be concerned that "global cartels' profits from sales outside of America may overwhelm losses from damages on sales within."[14]

Of course, not all cartels are caught and punished. Measured detection rates in the academic literature are well below 100 percent.[15] So the measurable financial rewards to cartel behavior are, by definition, understated, while the measurable financial penalties are correctly stated. Potential cartelists have an even stronger financial incentive to engage in illegal activity than that measured by Connor.

Further evidence that deterrence of international cartels is inadequate in practice is seen in corporate actions. Many companies caught participating in international cartels are serial offenders. These companies repeatedly form and participate in cartels, so they are apparently not deterred by current enforcement policy. For example, many of the LCDs cartel members are serial offenders, including Hitachi, LG, and Samsung.[16]

## III. SUPPLY CHAINS SHOULD BE ORGANIZED TO MAXIMIZE EFFICIENCY, NOT LEGAL GAINS

Many goods are produced in geographically concentrated regions, and this concentration occurs for a number of beneficial reasons. For example, external economies of scale can lead production to efficiently concentrate in one region.[17] In other cases, knowledge spillovers may tend to create incentives to geographically co-locate and capture synergies.[18]

International supply chains are organized in such as manner so as to capture these benefits. For instance, research has shown that foreign countries with lower costs and export-friendly policies have greater exports to U.S. multinational parents via their foreign affiliates.[19]

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[13] John Connor, *Effectiveness of Antitrust Sanctions on Modern International Cartels*, 6 J. INDUSTRY, COMPETITION & TRADE 212 (2006). These global cartels' price-fixing activities generally impacted the United States, as "many operated in as many as six continents, but most fixed prices in the 'Triad' of Western Europe, North America, and East Asia." *Id.* at 199.

[14] Eleanor Fox, testimony before the Antitrust Modernization Commission, 11 (Feb. 15, 2006).

[15] Peter Bryant & E. Woodrow Eckard, *Price Fixing: The Probability of Getting Caught*, 73 REV. ECON. & STATISTICS, 531-536 (1991; Emmanuel Combe, Constance Monnier, & Renaud Legal, *Cartels: The Probability of Getting Caught in the European Union*, Bruges European Economic Research Paper 12 (2008); and Peter Ormosi, *A Tip of the Iceberg? The Probability of Catching Cartels*, 29 J. APPLIED ECONOMETRICS 549-566 (2014). The effects of the U.S. leniency program on detection rates are measured in Nathan Miller, *Strategic Leniency and Cartel Enforcement*, AMER. ECON. REV. 750-768 (2009).

[16] Roger Noll describes the overlap of companies and even employees involved in the various electronics cartels. Roger Noll, *The DRAM Antitrust Litigation*, THE ANTITRUST REVOLUTION, 6th ed. (John Kwoka, Jr. & Lawrence White, eds. 2013).

[17] Paul Krugman, *Increasing Returns and Economic Geography*, 99 J. POLITICAL ECON. 483-499 (1991).

[18] Gregory Tassey, *Competing in Advanced Manufacturing: The Need for Improved Growth Models and Policies*, 28 J. ECON. PERSPECTIVES 27-48 at 30 (2014).

[19] Gordon Hanson, Raymond Mataloni Jr., & Matthew Slaughter, *Vertical Production Networks in Multinational Firms*, 87 REV. ECON & STATISTICS 664-678 (2005).

## IV. ECONOMIC CONSIDERATIONS PUSH FOR AN EXPANSIVE READING OF THE FTAIA

A policy that exempts purchases by foreign subsidiaries of U.S. multinational parents from the reach of private actions under U.S. antitrust law is likely to make U.S. consumers worse off.

First, such a policy would decrease deterrence of international cartels that affect U.S. consumers. International cartels are already inadequately deterred. In Motorola's case, removing 99 percent of its purchases from the reach of private enforcement of U.S. antitrust laws would likely make the LCDs cartel's decision to conspire against Motorola (and any similarly situated purchasers) financially beneficial. If Motorola proceeded to trial in the United States with only 1 percent of its purchases at issue, prevailed in totality, and received treble damages, the cartel would keep approximately 97 percent of the profits it made from conspiring against Motorola. Therefore, unless the cartel members paid government fines (or private damages in other venues) collectively equal to nearly all of their collusive gains, the cartel members would wind up benefitting from their conspiracy as far as sales to Motorola were concerned. As Connor's numbers indicate, it is unlikely government fines and private damages in other venues would be this large.

Second, such a policy would create incentives to distort supply chains of U.S.-based multinational buyers. For legal reasons, a U.S.-based multinational purchaser would face a new incentive to reorganize its supply chain to change the purchaser to the U.S. multinational parent and the delivery location to the United States. This would result in the loss of benefits from locating near key foreign suppliers. U.S. companies would face a new incentive to keep production in the United States, even when it would otherwise be efficient to move it offshore.

Foreign countries would likewise face an incentive to permit cartel formation to attract business to that nation.[20] These cartels would then be able to exploit any supply chains that had not changed by selling to foreign subsidiaries unable to pursue an antitrust claim in U.S. courts. Cartels would also have incentives to focus on making sales to counter-parties known to lack claims under U.S. antitrust law.

## V. CONCLUSION

Courts, lawyers, and economists will continue to attempt to provide meaning to the language of the FTAIA. The vacated panel decision emphasized comity considerations and formalistic distinctions in construing the language of the statute. But a decision which promotes comity considerations and formalistic distinctions above economic considerations will come at the expense of U.S. consumers in the future.

International cartels are recognized throughout the globe as undesirable. Yet they are inadequately deterred. International cartels often appear profitable, even after being caught. Many companies are serial offenders. Moreover, supply chains are organized in ways to

[20] Kathryn McMahon, *Competition Law and Developing Economies: Between 'Informed Divergence' and International Convergence*, in RESEARCH HANDBOOK ON INTERNATIONAL COMPETITION LAW, 231 (Ariel Ezrachi, ed. 2012); and Paul Victor, *Export Cartels: An Idea Whose Time Has Passed*, 60 ANTITRUST L.J. 571-581 at 571 (1991).

maximize efficiencies. Rules that create safe harbors for cartel members are likely to have adverse effects on efficient supply chains.

Both deterrence and supply chain considerations push for an expansive reading of the FTAIA—one that subjects foreign cartels to greater liability for their illegal actions, not less—and counsel for a decision allowing Motorola to pursue all its claims at trial.

To reach such a decision, the Court should focus attention on functional economic considerations, such as how Motorola's supply chain operated and how defendants' conduct toward Motorola impacted U.S. commerce. Given Motorola's allegations, its claims should meet the requirements of an expansively-read FTAIA and should be allowed to proceed to trial for a jury to hear.[21]

[21] Motorola's allegations are described in Appellant's Opening Brief (Aug. 29, 2014). For example, Motorola alleges it "there was an *actual single price* set in the United States between defendants and the U.S. company, and that price was applied *as such* to the rest of Motorola's global supply chain." *Id.* at 49 (emphasis in original). If true, the LCD cartel necessarily increased the prices of all of Motorola's panel purchases with the same conduct, regardless of (a) where the panels were delivered, (b) what happened to the panels after delivery, and (c) where a consumer ultimately took possession of a phone.

CPI COMPETITION POLICY INTERNATIONAL

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# Fermat's Principle and the FTAIA: What Courts Can Learn From Optics

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# Fermat's Principle and the FTAIA: What Courts Can Learn From Optics

James R. Martin[1]

Pierre de Fermat was a professional lawyer and amateur mathematician. Say what you will about our noble profession, Fermat's greatest contributions to society occurred during his off-hours. In 1662, Fermat stated his "principle of least time:" light follows the path that takes the least amount of time to travel. This principle has broad application beyond the world of quantum electrodynamics. Ants, for example, take the fastest route when traveling from point A to point B. If judges and United States prosecutors would apply this fundamental principle to the house-of-mirrors erected by the Foreign Trade Antitrust Improvements Act of 1982 ("FTAIA"), the law would be in far better shape than it is today.

Couched in "convoluted language," the FTAIA essentially states that the Sherman Act does not apply to purely foreign conduct unless that conduct exerted a "direct, substantial, and reasonably foreseeable effect" on domestic or import commerce *and* "such effect gives rise to a claim under the Sherman Act."[2] The FTAIA applies equally to civil and criminal cases.[3]

The Sherman Act is a criminal statute and does not provide a private right of action. Rather, Clayton Act Section 4 states that any person injured "by reason of anything forbidden in the antitrust laws" may sue for damages.[4] Structurally, the fact of a Sherman Act violation is a condition precedent to a private civil action. In fact, the version of the FTAIA passed in 1982 by the House Judiciary Committee actually used the phrase "such effect is the basis of ***the violation*** alleged."[5] Peter Rodino, then Chairman of the House Judiciary Committee, unilaterally changed that phrase at the eleventh hour to the current language cited above, believing that he was making a "minor clarification" that would make it "absolutely clear" that the domestic effect of the antitrust violation had to be an *anticompetitive* one.

Unfortunately, courts—including the U.S. Supreme Court—have viewed Chairman Rodino's misguided clarification almost exclusively through the refractory lens of private damage

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[2] *See, e.g., Animal Science Prods., Inc. v. China Minmetals, Corp.*, 654 F.3d 462, 465 (3d Cir. 2011); 15 U.S. C. § 6a.

[3] See, e.g., *U.S. v. Hui Hsiung*, 758 F.3d 1074, 1092 (9th Cir. 2014).

[4] 15 U.S.C. §15(a).

[5] H.R. Rep. No. 97-686 at 18 (emphasis added).

actions.[6] In these and other similar cases, the question posed has not been whether the conduct violated the Sherman Act but whether a particular plaintiff should be permitted to seek treble damages. Those, of course, are entirely different questions and the analyses of each will travel along different paths of least resistance. Trying to solve the first question with tools designed to answer the second, and *vice versa*, will only cause confusion.

The recent criminal and civil cases growing out of the liquid crystal display ("LCD") price-fixing cartel neatly illustrate the problem and the solution. In that case, a group of producers located primarily in Asia agreed to artificially inflate prices in the global market for LCD panels used in products like notebook computers and flat-screen televisions.

The United States Department of Justice Antitrust Division ("DOJ") obtained numerous guilty pleas from producers and persuaded a jury in San Francisco that a cartel producer, Taiwan-based AU Optronics ("AUO"), violated the Sherman Act. The Ninth Circuit affirmed the verdict in *U.S. v. Hui Hsiung*.[7] Presented with an opportunity to clarify the law, the Ninth Circuit merely recited the Ninth Circuit rule that "gives rise to a claim" means "causes *the plaintiff's* injury."[8] It then ducked the question and concluded that because the conduct involved import commerce the Sherman Act applied.[9] (One cannot criticize the Ninth Circuit for choosing the path of least resistance, but one can question why the Ninth Circuit chose to briefly focus on the issue at all.)

One United States-based victim of the conspiracy, Motorola Mobility LLC, sought treble damages arising, in part, from overcharges that its subsidiaries paid to AUO and other conspirators for LCD panels that its subsidiaries assembled into cellphones and shipped to the United States for sale to consumers. The Defendants argued that the FTAIA barred those damage claims because the overcharges did not arise from a U.S. effect.

The MDL judge, United States District Judge Susan Ilston, rejected the Defendants' argument. On remand to the transferor court, however, United States District Judge Joan Gottschall agreed with the Defendants and, without hearing oral argument, dismissed those aspects of Motorola's damage claims.[10] Then, in a remarkably terse opinion written by Judge Richard Posner, the Seventh Circuit summarily upheld Judge Gottschall's decision without even allowing Motorola to brief the issue.[11] The Seventh Circuit then vacated its opinion and directed the parties to submit briefs on the merits.[12]

The DOJ filed a brief as *amicus curiae* taking the position that the FTAIA's "gives rise to a claim" language should be flexibly interpreted so courts can weed out civil claims for foreign

[6] *See, e.g. F. Hoffmann-La Roche Ltd. v. Empagran S.A.*, 542 U.S. 155 (2004); *Empagran S.A. v. F. Hoffmann-LaRoche, Ltd.*, 417 F.3d 1267 (D.C. Cir. 2005); *Lotes Co. v. Hon Hai Precision Industry Co.*, 753 F.3d 395 (2d Cir. 2014).

[7] *U.S. v. Hui Hsiung*, *supra* note 3.

[8] *Id.* at 1094 (emphasis added).

[9] *Id.*

[10] *Motorola Mobility, Inc. v. AU Optronics Corp. et al.*, 2014 WL 258154 (N.D. Ill. Jan. 23, 2014).

[11] *Motorola Mobility LLC v. AU Optronics Corp.*, 746 F.3d 842 (7th Cir. 2014).

[12] *Motorola Mobility LLC v. AU Optronics Corp.,* Order dated July 1, 2014, Case No. 09 C 6610.

injury.[13] The DOJ argued that foreign jurisdictions' concerns about private damages claims are best addressed by this aspect of the FTAIA. Unable to cite legislative history or statutory authority to support its position, the DOJ instead turned to the U.S. Supreme Court's decision in *Associated General Contractors*[14] —the leading case on antitrust standing.[15] Thus, stuck on an Island of Standing, the United States then argued that *somebody* should be able to sue and therefore courts could create an exception to the *Illinois Brick* rule limiting standing to direct purchasers so that U.S. consumers could bring claims.[16] It is a convoluted theory that even carpenter ants would reject. Whatever the Seventh Circuit ultimately decides, *Motorola* seems destined to go before the U.S. Supreme Court.

The much simpler, and mathematically sensible, approach would be to acknowledge that the cartelists' guilty pleas and jury verdict already established that the Sherman Act applies to the conduct, i.e. the agreement among horizontal competitors to limit price competition in the global market for LCD panels. From there, Fermat's principle would counsel in favor of applying *Associated General Contractors* and its sequelae to the specific facts of Motorola's case.

Indeed, that is precisely why that line of cases exist. This approach give courts a set of factors to consider in deciding which victims of antitrust violations should be allowed to seek "the Clayton Act's rich bounty of treble damages."[17] These factors include:

1. the causal connection between the violation and the plaintiff's injury,
2. the type of harm the plaintiff suffered,
3. the directness of the plaintiff's injury,
4. whether more direct victims existed, and
5. whether the claim could create problems identifying and apportioning damages.[18]

Courts may also consider notions of comity.[19]

Thus, the Seventh Circuit need not consult the FTAIA at all in *Motorola,* nor should any court have to wander into the FTAIA's sinister house of mirrors to answer questions of standing.

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[13] Brief for the United States and the Federal Trade Commission as *Amici Curiaie* in Support of Neither Party (Sep. 5, 2014), available at http://www.justice.gov/atr/cases/f308400/308451.pdf.

[14] *Associated General Contractors of California, Inc. v. California State Council of Carpenters*, 459 U.S. 519 (1983)

[15] *Id. at* 14.

[16] *Id. at 20-21.*

[17] *In re LIBOR-Based Financial Instruments Antitrust Litig.*, 935 F.Supp.2d 666, 686 (S.D.N.Y. 2013).

[18] *Associated General Contractors* at 536-45.

[19] H.R. Rep. No. 97-686, at 13 (1982), reprinted in 1982 U.S.C.C.A.N. 2487, 2498 (citing *Timberlane Lumber Co. v. Bank of America*, 549 F.2d 597, 612-13 (9th Cir. 1976).

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## Repeal the FTAIA! (Or At Least Consider It as Coextensive with *Hartford Fire*)

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# Repeal the FTAIA!
# (Or At Least Consider It as Coextensive with *Hartford Fire*)

Robert E. Connolly[1]

## I. INTRODUCTION

The goal of this article is to advance two propositions: 1) that the Foreign Trade Improvements Act ("FTAIA") should be repealed; and 2) that *Motorola Mobility*[2] can be decided through the principles set forth in *Hartford Fire*[3] and *Illinois Brick.*[4]

The FTAIA was passed in 1982. A primary motivation behind the FTAIA was to give immunity to American exporters to engage in anticompetitive conduct—as long as it negatively affected only foreign consumers. With a purpose like that, what could go wrong? The FTAIA did not establish the extraterritorial reach of the Sherman Act and its repeal would not remove it.

Deciding *Motorola Mobility* through the application of *Hartford Fire* and *Illinois Brick* would preserve the ability of the U.S. Department of Justice's Antitrust Division ("DOJ") to prosecute international cartels that harm American consumers but, at the same time, give weight to foreign governments that seek to limit the reach of antitrust treble damage actions for sales made abroad.

## II. THE FTAIA IS UNNECESSARY AND HAS HARMFUL SIDE EFFECTS

The FTAIA was passed when the world's landscape of antitrust enforcement was dramatically different. The Supreme Court explained "[t]he FTAIA seeks to make clear to American exporters (and to firms doing business abroad) that the Sherman Act does not prevent them from entering into business arrangements (say, joint selling arrangements), however anticompetitive, as long as these arrangements adversely affect only foreign markets."[5]

In 1982 there wasn't much in the way of antitrust enforcement outside of the United States and Canada. To the contrary, many foreign governments encouraged cooperation or "harmonization." But today there are over 100 robust competition enforcement agencies worldwide. This growth in international enforcement, particularly against cartels, is largely due to the leadership of the United States. It seems impolite for the United States to provide immunity to executives to fix prices for export while at the same time seeking extradition of foreign executives to face a maximum of 10 years in jail for price-fixing.

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[2] Motorola Mobility LLC v. AU Optronics Corp, 746 F.3d 842 (2014), reh'g granted and opinion vacated by Motorola Mobility LLC v. AU Optronics Corp., 2014 U.S. App. LEXIS 12704 (7th Cir. July 1, 2014).

[3] Hartford Fire Ins. Co. v. Cal., 509 U.S. 764 (1993).

[4] Illinois Brick Co. v. Illinois, 431 U.S. 720 (1977).

[5] F. Hoffmann-LaRoche LTD v. Empagran S.A. 542 U.S. 155, 161 (2004).

Moreover, in a global economy, it's hard to believe that allowing domestic companies to fix export prices would not have some adverse effect on domestic prices. At a minimum, immunity for export price-fixing can also provide cover for domestic price-fixing. Finally, even if a U.S. exporter is doing business in a country where price-fixing is rampant, American law should encourage that firm to compete and expand output, not artificially raise prices.

Besides having some unpleasant side effects, the FTAIA is simply unneeded. The FTAIA did not create the extraterritorial reach of the Sherman Act. Judge Hand long ago established in *Alcoa*[6] that "the Sherman Act applies to foreign conduct that was meant to produce and did in fact produce some substantial effect in the United States."[7] The FTAIA makes the Sherman Act inapplicable to conduct involving export or wholly foreign commerce except when that conduct has a "direct, substantial and reasonably foreseeable effect" on U.S. commerce and that effect "gives rise to a claim." The FTAIA can be read, as some courts have, as consistent with *Hartford Fire*. The FTAIA is simply not needed, and if the aim was to clarify the extraterritorial reach of the Sherman Act, the statute has fallen short.

## III. UPON REHEARING, *MOTOROLA MOBILITY V. AU OPTRONICS* SHOULD BE RESOLVED THROUGH THE LENS OF *HARTFORD FIRE* AND *ILLINOIS BRICK*

The Seventh Circuit issued an opinion, now vacated, in *Motorola Mobility* and the matter is scheduled for rehearing. Motorola seeks treble damages for LCD panel purchases made abroad by its foreign subsidiaries where those LCD panels were assembled into cell phones that were then sold in the United States. In order for this foreign commerce to be brought back within the Sherman Act under the FTAIA, Motorola had to show that defendant's actions had "a direct, substantial, and reasonably foreseeable effect" on commerce within the United States.

In the vacated opinion the court found the effect was not direct because the defendants sold the price-fixed panels to foreign companies, i.e. Motorola's subsidiaries. While the panels were a component of a finished product that was then sold in the United States, the court found that the effect on domestic commerce was indirect and barred by the FTAIA.

## IV. THE ANTITRUST DIVISION SHOULD HAVE JURISDICTION TO PROSECUTE COMPONENT PRICE-FIXING

The United States is not a party in *Motorola Mobility* but has filed several amicus briefs. The interpretation of the FTAIA could substantially impinge the DOJ's ability to prosecute foreign cartels that adversely affect domestic consumers. As the government notes in its amicus filings, there is a difference between actions brought by the DOJ and private class action damages. *Motorola Mobility* can be decided in such way as to recognize these differences. The court can find jurisdiction under the FTAIA for DOJ prosecutions while addressing the concerns raised by China, Japan, Korea, and Taiwan about an unduly expansive application of U.S. law they claim would undermine principles of international comity.

The FTAIA by its terms does not apply to domestic commerce or import trade or commerce. There is, therefore, no dispute that price-fixed panels sold directly to customers in the

[6] United States v. Aluminum Co. of America, 148 F.2d 416 (2d Cir. 1945).

[7] *Hartford Fire*, at 796.

United States are within the reach of the Sherman Act. But, the FTAIA covers foreign commerce where (1) the foreign conduct has a "direct, substantial, and reasonably foreseeable effect" on U.S. domestic, import, or certain export commerce, and (2) that effect "gives rise to a claim under" the Sherman Act.

This section must have some meaning besides direct imports because direct imports are already excluded from the FTAIA. As the government argues, the effect on domestic commerce of the LCD panel price-fixing on sales to Motorola's subsidiaries was direct. The rigged/inflated prices were passed directly on to domestic consumers of the imported cell phones. The effect was substantial; LCD panels constitute a large portion of the price of cell phones and millions of dollars of panels were imported into the United States in cell phones. Finally, it was reasonably foreseeable that raising the price of a major component of cellphones would raise the price of cellphones sold in import and domestic commerce.

The United States requested that the panel "hold that a conspiracy to fix the price of a component can directly affect import commerce in finished products incorporating that component and that the conspiracy in this case did directly affect that commerce."[8] Several circuits have agreed with the reasoning of the government. The Second Circuit recently adopted a "reasonably proximate causal nexus test." In *Lotes,*[9] the court rejected the interpretation advanced by the Ninth Circuit in *LSL Biotechnologies,*[10] whereby an effect is "direct" if it follows as an immediate consequence. Instead, the court wrote, "We agree with Lotes and amici [the United States] that this less stringent approach (reasonably proximate causal nexus) approach reflects the better reading of the statute."

Finding jurisdiction for the United States to prosecute component price-fixing need not ignore the international comity concerns of foreign governments. No nation has objected to the DOJ's successful prosecution of foreign companies and even citizens of that country in the LCD panel investigation. As the United States notes in its brief, the DOJ seriously considers the views of foreign nations before bringing cases. And, as the world's leading competition agency, consumers everywhere benefit when the DOJ breaks up international cartels. In fact, with the DOJ leading the way, many foreign competition enforcement agencies have also brought governmental enforcement actions against cartel members. Significant cooperation among enforcement agencies in prosecuting international cartels is a high priority for each government that filed an amicus brief. As a prosecuting entity, the DOJ has "skin in the game" to preserve strong relations with its foreign counterparts.

As discussed below, the comity considerations with private plaintiffs are quite different. "[P]rivate plaintiffs," in contrast, "often are unwilling to exercise the degree of self-restraint and consideration of foreign governmental sensibilities generally exercised by the U.S.

[8] *See* Brief for the United States and the Federal Trade Commission as Amici Curiae in Support of Neither Party, September 5, 2014, p. 7, *available at* http://www.justice.gov/atr/cases/f308400/308451.pdf.

[9] Lotes Co. v. Hon Hai Precision Industry Co., 753 F.3d 395, 410 (2d Cir. 2014).

[10] United States v. LSL Biotechnologies, 379 F.3d 672 (9th Cir. 2004). The Ninth Circuit's holding was based on the view that the FTAIA limited the common law extraterritorial reach of the Sherman Act. Repeal of the FTAIA would remove this conflict.

Government."[11] This helps explains why foreign government amici briefs were filed in *Motorola Mobility* [Japan, China, Taiwan, and Korea] but not in any DOJ criminal prosecutions.

## V. COMITY CONSIDERATIONS WARRANT APPLICATION OF THE *ILLINOIS BRICK* RULE TO COMPONENT PRICE-FIXING.

It is an open question whether the *Illinois Brick* bar exists when direct purchasers cannot bring Sherman Act claims because they cannot satisfy FTAIA requirements. The United States argues that the *Illinois Brick* doctrine should be construed to permit damage claims for the first purchaser in affected domestic commerce when the FTAIA bars direct purchasers' claims because, otherwise, it is possible no private plaintiff could recover damages under the federal antitrust laws.[12]

Some of the arguments the DOJ has made to support plaintiffs' needs to bring component treble damage cases are questionable. For example, in one amicus filing the United States noted "that price fixers' host countries often have no incentive to enforce their antitrust laws" and "would logically be pleased to reap economic rents from other countries"[13] (citing *Minn-Chem*[14]). The same brief, however, points out that a global effort against hard-core cartels has emerged partly due to the work of the Organization for Economic Cooperation and Development ("OECD") and the International Competition Network.

The world, led by the DOJ, has changed dramatically since the FTAIA was passed. It is no longer accurate to suggest that other nations would be pleased to reap the economic rents gained by price-fixing component goods that eventually end up being sold in finished products in the United States. After all, Chinese and Taiwanese citizens also buy products with LCD screens as a component. It is notable that DOJ international cartel investigations are typically conducted with the cooperation of many nations, which then bring their own enforcement actions.

The United States has argued that some of the foreign governments that have filed amicus briefs urging the court to limit the reach of the FTAIA have themselves brought cases against foreign sellers. But, in one example, i.e. Korea bringing an action against graphite electrode manufacturers, the product was shipped directly into Korea—commerce that would not fall under the FTAIA. Even in other given examples, e.g. actions by Japan and the European Union, these were governmental enforcement actions arising from investigations coordinated with the DOJ. The United States' position, perhaps in an effort to not unduly undercut private plaintiffs, does not appreciate or minimizes the different comity considerations between government enforcement of the antitrust laws and the rights of private parties to seek class action treble damages. But, there is a world of difference.

The United States wrote in its amicus brief: "Anticompetitive conduct involving components in wholly foreign commerce often would have no practical effect on U.S. commerce,

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[11] *Empagran,* 542 U.S. at 171 (quoting Joseph P. Griffin, *Extraterritoriality in U.S. and EU Antitrust Enforcement*, 67 ANTITRUST L.J. 159, 194).

[12] *See* Brief for the United States and the Federal Trade Commission as Amici Curiae in Support of Neither Party, September 5, 2014, p. 6, *available at* http://www.justice.gov/atr/cases/f308400/308451.pdf.

[13] Motorola Mobility v. AU Optronics, Case No. 09-cv-6610 (N.D. Ill.), Supplemental Brief For the United States as Amicus Curiae, June 27th, 2014, *available at* http://www.justice.gov/atr/cases/f306700/306783.pdf. P.6-7.

[14] *Minn-Chem, Inc. v. Agrium, Inc.*, 683 F.3d 845 (7th Cir. 2012) (*en banc*).

in which case the Sherman Act would not apply."[15] This is the heart of the problem: In today's global economy it is common for products bought by American consumers to contain components manufactured and sold overseas. The United States government and the private plaintiffs bar are likely to make significantly different calls on when the conduct has a "direct, substantial, and reasonably foreseeable effect" on U.S. commerce. From a comity point of view, foreign governments may well, and seemingly do, have a different view of the positions of the U.S. government and the private plaintiffs bar.

The *Motorola Mobility* case itself is on its fifth year. *Animal Science*, a Third Circuit case involving foreign commerce and FTAIA issues was first filed in 2005 and certain plaintiffs have just been granted to amend the complaint. Since the FTAIA requirements are not a jurisdictional requirement, but a substantive element of the offense, it can take an enormous amount of expensive litigation to determine the applicability of the FTAIA on a case-by-case basis in component cases. The ubiquity of foreign-made components in products sold in the United States is likely what led the Seventh Circuit in the vacated opinion to state: "The position for which Motorola contends would if adopted enormously increase the global reach of the Sherman Act, creating friction with many foreign countries and 'resent[ment at] the apparent effort of the United States to act as the world's competition police officer,' a primary concern motivating the foreign trades act."[16]

In *Empagran* the Supreme Court observed "even where nations agree about primary conduct, say price fixing, they disagree dramatically about appropriate remedies." The Court also remarked that the application of American private treble damage remedies has generated controversy. Several countries (including Canada, Japan, and Germany) filed amicus briefs in *Empagran*. These countries argued "to apply our remedies would unjustifiably permit their citizens to bypass their own less generous remedial schemes, thereby upsetting a balance of competing considerations that their own domestic antitrust laws embody."[17] The Seventh Circuit has said: "U.S. antitrust laws are not to be used for injury to foreign customers."[18] The fact is that when Motorola operates subsidiaries in foreign countries it is a "citizen" of the country it has chosen.

## VI. APPLYING *ILLINOIS BRICK* TO COMPONENT PRICE-FIXING IS FAIR TO COMPANIES WITH OVERSEAS SUBSIDIARIES

It is fair to require foreign subsidiaries of American companies to seek remedy in the courts of the country in which they choose to incorporate. Companies operate overseas facilities to take advantage of many legal provisions of that country: labor law, environmental law, and tax law. In non-legal terms: "You take the good with the bad." By contrast, American consumers have no realistic choice but to buy finished goods that are assembled from components sold and assembled around the world.

Therefore, the antitrust laws should be read—where possible—to allow governmental enforcement against international cartels that were meant to have, and have had, a substantial

[15] *Motorola Mobility*, September 5, 2014 amicus filing of the United States, p. 18.
[16] *Motorola Mobility*, 746 F.3d at 845.
[17] *Empagran*, at 167.
[18] *Minn Chem*, at 858.

effects on domestic commerce, whether that commerce is a direct import, sold through a trading company, or a component destined for shipment to the United States. The DOJ even has the authority to seek disgorgement of profits if it believes it necessary for adequate punishment and deterrence. A foreign subsidiaries position is more akin to an American citizen living overseas who buys price-fixed goods but then must seek any remedies under the laws country she has chosen to live in.

## VII. U.S. PARENT CORPORATE PURCHASERS ARE NOT WITHOUT REMEDY

Domestic corporate purchasers are not without remedy when buying component parts from foreign vendors. First, the U.S. parent could buy directly from the foreign vendor and preserve the right to sue as a direct purchaser (while trading off the benefits the company gained from operating through a foreign subsidiary). Or, if a U.S. parent doesn't think that antitrust laws are sufficiently, or fairly, enforced in a given country, they certainly don't have to set up a subsidiary there.

A U.S. parent also could, by contract, try to negotiate an assignment of rights from their subsidiary. The subsidiary, of course, can seek a remedy in the country where it has located. While beyond the scope of this article it is worth noting that the right of private action is expanding around the globe, although American-style class actions regimes have not met a warm reception.[19] So, an adverse ruling in *Motorola* would not eliminate every avenue of damage redress for component price-fixing.

## VIII. CONCLUSION

There is overwhelming evidence that the LCD cartel members meant to and did produce substantial anticompetitive effects on commerce in the United States. The *Motorola Mobility* court should reach a decision that preserves the ability of the DOJ to protect American consumers and continue to lead the way in prosecuting international cartels—including appropriate component cartels. The court could also acknowledge the comity concerns of foreign nations and find application of *Illinois Brick* a bar to foreign component civil damage cases. This of course would not address every legal and policy question (for example there are exclusions to *Illinois Brick* such as state actions) but it would be a start.

[19] Also, many states have *Illinois Brick* repealer statutes. Component class action suits may be feasible in these states.