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ANTITRUST TRADE AND PRACTICE

Expert Analysis

'Lotes' and the Ever Expanding Reach of U.S. Antitrust Laws

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The Foreign Trade Antitrust Improvements Act (the FTAIA)—a federal statute that governs the reach of the Sherman Act to foreign conduct—has become a central focus of antitrust law in recent years as U.S. antitrust authorities aggressively ramped up efforts to police anticompetitive conduct abroad. Unfortunately for parties involved in litigation, particularly defendants, the increasing importance of the FTAIA has coincided with significant turmoil relating to judicial interpretation of the law. Specifically, several recent circuit court rulings have shifted the law in a decidedly pro-plaintiff direction by simultaneously upsetting established precedent relating to procedural aspects of the FTAIA and advancing new approaches to interpreting its substantive provisions.

The U.S. Court of Appeals for the Second Circuit's decision last month in *Lotes v. Hon Hai Precision Industry*[1] is the latest contribution to this rapidly evolving jurisprudence, as the court grappled with three critical issues: (1) whether the FTAIA's limits on the Sherman Act are jurisdictional or substantive, (2) the correct standard to evaluate whether foreign conduct has a "direct, substantial, and reasonably foreseeable effect" on U.S. commerce and (3) the proper framework for assessing whether the anticompetitive effects "give rise to a claim under" the Sherman Act. While the Second Circuit's holding with respect to the first issue has garnered the most attention, the latter two questions are more likely to be the focal points of future litigation involving the FTAIA.

Anyone doing business abroad should be aware of the changing landscape surrounding the FTAIA. Further, both potential plaintiffs and defendants should remain mindful of the many yet to be resolved issues that are likely to shape the reach of the Sherman Act to foreign conduct.

FTAIA

Congress passed the FTAIA in 1982 to "clarify the legal standard determining when American antitrust law governs foreign conduct."[2] Specifically, the FTAIA provides that the Sherman Act "shall not apply to foreign conduct" except where that conduct "has a direct, substantial, and reasonably foreseeable effect" on domestic commerce, imports or exports and where such effect "gives rise to a claim under [the Sherman Act]."[3] As observed by the court in *Lotes*, the FTAIA requires "two distinct causation inquiries, one asking whether the defendants' foreign conduct caused a cognizable domestic effect, and the other asking whether that effect caused the plaintiff's injury."[4]

Evolution of FTAIA

Prior to 2006, courts consistently treated the FTAIA as a limit on a court's subject matter jurisdiction rather than an issue on the merits.[5] In 2006, however, the Supreme Court in *Arbaugh v. Y&H Corp.* admonished courts not to read jurisdictional limits into federal statutes "when Congress does not rank a statutory limitation on coverage as jurisdictional."[6] While neither *Arbaugh* nor its progeny specifically addressed the FTAIA, the absence of express jurisdictional language in the FTAIA left lower courts to reconcile existing precedent—which treated the FTAIA as jurisdictional—with the sweeping but imprecise dictates of the court in *Arbaugh*.

In 2011, the U.S. Court of Appeals for the Third Circuit became the first circuit court to address the issue in *Animal Science Products v. China Minmetals*,[7] where it overturned its own precedent construing the FTAIA as a jurisdictional restriction. (Co-author Shepard Goldfein represents China Minmetals in

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this case.) After engaging in a lengthy review of the text of the FTAIA, the court observed that "the statutory text is wholly silent in regard to the jurisdiction of the federal courts" and, thus, "[a]ssessed through the lens of *Arbaugh*… the FTAIA's language must be interpreted as imposing a substantive merits limitation rather than a jurisdictional bar."[8]

Less than a year later, the U.S. Court of Appeals for the Seventh Circuit in *Minn-Chem. v. Agrium*[9] joined the Third Circuit in overruling its own precedent and found that the limitations of the FTAIA are substantive and not jurisdictional in light of *Arbaugh*. Accordingly, the Seventh Circuit evaluated the plaintiff's claims under the FTAIA on the merits, thereby wading into other relatively uncharted waters of assessing the proper standard for whether conduct has a "direct" effect on U.S. commerce.

The only circuit court that had previously addressed this question was the U.S. Court of Appeals for the Ninth Circuit in *United States v. LSL Biotechnologies*, which held that an effect is only "direct" if it is the "immediate consequence" of the defendant's alleged anticompetitive conduct.[10] The Seventh Circuit rejected that approach, adopting instead a less precise formulation articulated by the Department of Justice and Federal Trade Commission that "'direct' means only 'a reasonably proximate causal nexus.'"[11]

'Lotes' Decision

In *Lotes*, plaintiff and defendants were competing manufacturers of USB connectors, which the parties exclusively manufactured and sold in China and Taiwan. The parties sold their products to manufacturers of more advanced computer components, which then were sold to and included in brand-name computers sold throughout the world, including the United States. Plaintiff brought an action against the defendants under Sections 1 and 2 of the Sherman Act in the Southern District of New York for failing to license certain necessary patents to the plaintiff on reasonable and non-discriminatory terms. Plaintiff alleged that defendants' refusal to license the patents prevented it from competing in the USB connector business, which subsequently resulted in higher prices for those connectors and, ultimately, higher prices for computers sold in the United States.

Defendants moved to dismiss the claims on grounds that the alleged conduct did not fall within the limits of the FTAIA. The district court granted the motion, holding that the limitations of the FTAIA were a question of subject matter jurisdiction and that the plaintiff failed to show a direct effect on U.S. commerce.[12]

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On the jurisdictional question, the district court acknowledged the contrary holdings in *Animal Science* and *Minn-Chem*, but noted that "while current thinking may point against finding the FTAIA to be jurisdictional" it was bound by the Second Circuit's ruling in *Filetech v. France Telecom*,[13] which predated *Arbaugh* and held that the FTAIA was jurisdictional.[14] On the direct effect question, the court adopted the Ninth Circuit's "immediate consequence" standard and concluded that the alleged conduct was too attenuated from U.S. commerce to grant the court jurisdiction under the FTAIA.

The Second Circuit affirmed the dismissal, but disagreed with the lower court on both the jurisdictional question and the standard for assessing the direct effect requirement. On the jurisdictional question, the Second Circuit joined the Third and Seventh Circuits in overturning its pre-*Arbaugh* precedent.[15] The Second Circuit also rejected the district court's adoption of the "immediate consequence" standard. Instead, the Second Circuit again agreed with the court in *Minn-Chem*, concluding that the "reasonably proximate causal nexus" standard is better suited to deal with the practical realities of complex international supply chains "while still addressing antitrust law's classic aversion to remote injuries."[16]

Nevertheless, the Second Circuit affirmed the district court's dismissal, finding that it need not address "the rather difficult question" of whether defendants' conduct had a direct effect because any effect did not "'give[] rise to'" the plaintiff's claims.[17] Agreeing with the Eighth, Ninth and D.C. Circuits, the Second Circuit held that "the domestic effect must proximately cause the plaintiff's injury."[18] Applying that standard on the record before it, the Second Circuit concluded that even assuming defendants' conduct had a direct effect on U.S. commerce by causing prices to rise, the plaintiff's alleged antitrust injury actually preceded, rather than resulted from, any anticompetitive effect in the United States.[19]

Looking Forward

The Lotes decision is notable for the Second Circuit's alignment with other circuits on the jurisdictional issue. Yet, *Lotes* more likely signals a resolution to the jurisdictional question rather than a deepening of a circuit split. While the Second, Third and Seventh Circuits are now at odds with authority in other circuits, all three circuits to address the issue, post-*Arbaugh*, have unequivocally arrived at the same conclusion. In addition, at least one district court in California has declined to follow the leading case on the other side of the split, *LSL Biotechnologies*,[20] further suggesting that courts nationwide may be nearing a consensus.[21]

Reaching a similar consensus on the proper standard to evaluate a "direct" effect that causes an antitrust injury

appears significantly more complex and doubtful. The Lotes decision deepens an emerging circuit split between the Seventh and Ninth Circuits, where lower courts continue to apply the "immediate consequence" test from *LSL Biotechnologies*.[22] At this time, there is no reason to suspect that the Ninth Circuit will overturn itself on that issue because, unlike on the jurisdictional issue, there has been no guidance from the Supreme Court that dictates such a change.

The Lotes court's adoption of the proximate cause standard for what "gives rise to" a claim under the Sherman Act is likely to become a focal point of future litigation involving the FTAIA.

In addition, neither the Second nor Seventh Circuits have substantial judicial weight behind their more lax formulation, as both largely rely on arguments put forth by the U.S. antitrust authorities in amicus briefs. Further, it is conceivable, if not likely, that other circuit courts could side with the Ninth Circuit in adopting the "immediate consequence" test; indeed, even the Lotes court cautioned that "proximate causation is a notoriously slippery doctrine."[23]

Further, the Lotes court's adoption of the proximate cause standard for what "gives rise to" a claim under the Sherman Act also is likely to become a focal point of future litigation involving the FTAIA. While at this stage the circuits to address the issue have come out unanimously, there are many courts yet to take up the issue. In addition, given the unsettled state of the law, defendants likely will seize on this arguably narrow interpretation as the primary means to try to avoid claims based on purely foreign conduct. Accordingly, both private plaintiffs and the U.S. antitrust authorities are likely to become much more involved in trying to sway courts to adopt a more plaintiff-friendly approach to the second prong of the FTAIA.

Practical Considerations

As noted above, defendants in actions involving the FTAIA should be prepared for the court to treat the law's limitations as a merits issue rather than a jurisdictional question. Specifically, attempts to escape a claim under the FTAIA now must be brought in a 12(b)(6) motion rather than the more liberal standard of 12(b)(1).

In addition, parties should be prepared for a court to adopt either of the two existing standards for direct effects. Specifically, given the state of the law, defendants should be prepared to argue that the alleged conduct does not satisfy the "reasonably proximate causal nexus" analysis articulated by *Lotes* and *Minn-Chem*. While there is little guidance on what satisfies this standard, the court in *Lotes* recognized that the inquiry "will depend on many factors, including the structure of the market and the nature of the commercial relationships at each link in the causal chain." Again, while this formulation may favor plaintiffs, even the Seventh Circuit recently held in *Motorola Mobility v. AU Optronics* that there is certain conduct, which, on the face of the pleading, is too attenuated to form a "reasonably proximate causal nexus."[24] Notably, however, the Seventh Circuit just vacated its decision in that case and will rehear the appeal.

Finally, the second prong of the FTAIA likely will play a more prominent role in FTAIA litigation in light of the procedural changes and the adoption of a less rigorous standard for satisfying the first prong of the FTAIA. While many of the changes in judicial interpretation of the FTAIA certainly should give defendants pause, existing precedent involving the "gives rise to" requirement, including *Lotes*, provides some comfort that the FTAIA's exceptions may prevent speculative claims.

Conclusion

In the wake of *Arbaugh*, courts have reexamined nearly all aspects of the FTAIA. Eight years after that ruling, it has become reasonably clear that courts must now evaluate the FTAIA on the merits rather than as a jurisdictional question. In this context, the standards used by courts to interpret the two prongs of the FTAIA will become increasingly important as the law evolves. In particular, a significant circuit split looms with respect to the proper standard for evaluating what is a "direct" effect on domestic commerce. While it is still too early to tell how and when that conflict will be resolved, foreign corporations should be ever mindful of the changing and increasingly complex contours of the FTAIA.

1. No. 13-2280, 2014 WL 2487188 (2d Cir. June 4, 2014) (to be published in F.3d).
2. Id. at *7.
3. 15 U.S.C. §6a.
4. *Lotes*, 2014 WL 2487188, at *16.
5. See, e.g., *United States v. LSL Biotechnologies*, 379 F.3d 672, 683 (9th Cir. 2004); *Turicentro v. Am. Airlines*, 303 F.3d 293, 300 (3d Cir. 2002); *United Phosphorus v. Angus Chem.*, 322 F.3d 942, 948 (7th Cir. 2003).
6. 546 U.S. 500, 516 (2006).
7. 654 F.3d 462, 465 (3d Cir. 2011).
8. Id. at 468-69.
9. *Minn-Chem v. Agrium*, 683 F.3d 845, 852-53 (7th Cir. 2012).
10. 379 F.3d 672, 680 (9th Cir. 2004).
11. *Minn-Chem*, 683 F.3d at 856-57 (citation omitted).
12. *Lotes v. Hon Hai Precision Indus.*, No. 12 Civ. 7465(SAS), 2013 WL 2099227 (S.D.N.Y. May 14, 2013), aff'd, 2014 WL 2487188 (2d Cir. June 4, 2014).
13. *Filetech v. France Telecom,* 157 F.2d 922, 931 (2d Cir. 2008).
14. *Lotes,* 2013 WL 2099227, at *7.
15. *Lotes Co. v. Hon Hai Precision Indus. Co.*, No. 12-2280, 2014 WL 2487188, at *10 (2d Cir. June 4, 2014).
16. Id. at *14-15.
17. Id. at *16.
18. Id. (citing *In re Dynamic Random Access Memory (DRAM) Antitrust Litig.*, 546 F.3d 981, 987 (9th Cir. 2008); *In re Monosodium Glutamate Antitrust Litig.*, 477 F.3d 535, 538 (8th Cir. 2007); *Empagran v. F. Hoffman-LaRoche*, 417 F.3d 1267 (D.C. Cir. 2005)).
19. Id. at *18.
20. *United States v. LSL Biotechnologies*, 379 F.3d 672 (9th Cir. 2004).
21. See *In re TFT-LCD (Flat Panel) Antitrust Litig.*, 822 F.Supp.2d 953, 958-59 (N.D. Cal. 2011) (adopting the standard from *Animal Science Prods. v. China Minmetals* Corp., 654 F.3d 462 (3d Cir. 2011)).
22. See id. at 964.
23. *Lotes*, 2014 WL 2487188, at *15.
24. See *Motorola Mobility v. AU Optronics*, 746 F.3d 842 (7th Cir. 2014), vacated, reh'g granted, No. 14-8002 (7th Cir. July 1, 2014).