

Antitrust Update: Second Circuit Adopts Rule Making it Easier to Find Liability for Foreign Anticompetitive Conduct

On June 4, 2014, the Second Circuit issued its decision in *Lotes Co., Ltd. v. Hon Hai Precision Industry Co.*, an important ruling on the reach of the U.S. antitrust laws to foreign conduct.¹

The Foreign Trade Antitrust Improvements Act ("FTAIA")² limits the reach of U.S. antitrust liability to foreign conduct that has a "direct, substantial, and reasonably foreseeable effect" on U.S. commerce. In *Lotes*, the Second Circuit construed this language to require plaintiffs to show only a "reasonably proximate causal nexus" between the conduct and the effect on U.S. domestic commerce or import commerce, a view recently endorsed by the Seventh Circuit in *Minn-Chem*.³ This view contrasts with the Ninth Circuit's more stringent standard that the effect on U.S. commerce be an "immediate consequence" of the anticompetitive conduct.⁴

This Alert analyzes the Second Circuit's rationale, discusses its relative lack of guidance, and identifies other pending cases and decisions on the same issue.

Case Background

Lotes Co., Ltd. ("Lotes") is a Taiwanese corporation that manufactures USB connectors for electronic devices. It sells to Taiwanese and Chinese Original Design Manufacturers that assemble computer products incorporating USB connectors for sale around the world, including in the U.S. Defendants compete with Lotes in making and manufacturing USB connectors. Lotes alleged that defendants engaged in anticompetitive conduct by refusing to license USB 3.0 technology on terms required by a standard setting organization. The refusal to license, combined with the threat of patent litigation if Lotes uses the technology, allegedly threatened to shut down Lotes' factories in China, decrease competition in USB 3.0 connectors, and ultimately lead to price increases in the U.S. Lotes filed suit in the Southern District of New York on October 4, 2012. On May 14, 2013, the district court dismissed the action for lack of subject matter jurisdiction, holding that the FTAIA restrictions were jurisdictional⁵ and that Lotes failed to plausibly allege a "direct, substantial, and reasonably foreseeable effect" on U.S. domestic or import commerce.⁶

The Second Circuit's Decision

In *Lotes*, the Second Circuit rejected the district court's analysis and held that: 1) the FTAIA is a substantive, not jurisdictional statute; and 2) "direct effect" under the FTAIA means a "reasonably proximate causal nexus" to the anticompetitive conduct. Still, the Second Circuit affirmed the district court's dismissal of the complaint, holding that any direct effect caused by defendants' foreign anticompetitive conduct did not "give rise" to Lotes's claims.

First, the Second Circuit quickly determined that the FTAIA's threshold requirements are substantive and not jurisdictional since there is no clear statement from Congress directing that the requirements be jurisdictional.⁷

Second, the Second Circuit rejected the district court's interpretation – based on a 2004 Ninth Circuit ruling⁸ – that construed the FTAIA's "direct effect" element to require the effect to follow "as an immediate consequence of the

¹ *Lotes Co., Ltd. v. Hon Hai Precision Industry Co.*, No. 13-2280, slip op. (2d Cir. June 4, 2014).

² 15 U.S.C. § 6a. The FTAIA applies to both criminal and civil antitrust conduct.

³ *Minn-Chem, Inc. v. Agrium, Inc.*, 683 F.3d 845, 857 (7th Cir. 2012) (en banc).

⁴ *United States v. LSL Biotechnologies*, 379 F.3d 672 (9th Cir. 2004).

⁵ *Lotes Co. v. Hon Hai Precision Indus. Co.*, 2013 U.S. Dist. LEXIS 69407, at *25 (S.D.N.Y. May 14, 2013).

⁶ *Id.* at *35-36.

⁷ *Lotes Co., Ltd. v. Hon Hai Precision Industry Co.*, No. 13-2280, slip op. at 22-30 (2d Cir. June 4, 2014).

⁸ *United States v. LSL Biotechnologies*, 379 F.3d 672 (9th Cir. 2004).

defendant's activity."⁹ Under that interpretation, the district court in *Lotes* found that there could be no antitrust liability because price increases of electronic devices in the U.S. did not follow as an immediate consequence of the attempted monopolization of the foreign USB 3.0 connector market, even though such conduct may have led to higher prices for U.S. consumers.¹⁰ Troubled by such an outcome, the Second Circuit adopted the interpretation advocated by the U.S. Department of Justice's Antitrust Division and the Federal Trade Commission in amicus briefs and adopted by the Seventh Circuit sitting en banc in *Minn-Chem*.¹¹ Under that test, a direct effect requires only that the anticompetitive conduct have a "reasonably proximate causal nexus" to the adverse effect on domestic commerce.¹²

Third, the court found that, regardless of what is required to show a "direct effect" to satisfy the FTAIA, there was no antitrust violation where the domestic effect caused by defendants' conduct did not "give rise" to *Lotes's* claims, as also required by the FTAIA.¹³ In *Lotes*, this meant that antitrust liability would only attach if higher prices in the U.S. proximately caused *Lotes's* injury.¹⁴ In fact, *Lotes's* injury was caused directly by defendants' exclusionary conduct outside the U.S. – the Chinese patent infringement suits.¹⁵ If anything, the court held, the causal relationship was backwards since *Lotes's* injury of being excluded from the market allegedly caused the increased prices.¹⁶ Since an effect can never precede its cause, the court found that higher prices did not "give rise" to *Lotes's* injury.¹⁷ As the court explained: "The FTAIA thus includes 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."¹⁸

The Implications of the *Lotes* Decision on Antitrust Liability

Interpreting the FTAIA in a way that could lead to increased antitrust liability: In *Lotes*, the Second Circuit joined the Seventh Circuit in interpreting the FTAIA in a way that could expand the reach of the U.S. antitrust laws. The Second Circuit recognized that this less stringent interpretation is necessary in light of today's global supply chain. "[A]nticompetitive injuries can be transmitted through multi-layered supply chains" and the Ninth Circuit's restrictive "immediate consequence" approach would give a free pass to almost any anticompetitive conduct that occurred outside the U.S.¹⁹ The court appeared to view its ruling as necessary to keep pace with the realities of increased globalization and the recognition that manufacturing of items abroad could, in some cases, harm U.S. consumers.

Will the Ninth Circuit join its colleagues in this narrower FTAIA interpretation? In choosing to adopt the advocated by antitrust regulators and the Seventh Circuit, the Second Circuit pointedly disagreed with the Ninth Circuit's reasoning in requiring the "immediate consequence" interpretation of "direct effect."²⁰ The court criticized the Ninth Circuit's choice of one dictionary meaning over another and its reliance on the Supreme Court's interpretation of a "nearly identical term" that was in a statute with different language and a different purpose.²¹ The Ninth Circuit will have an opportunity to revisit this issue in the appeal of the *AU Optronics* case; the antitrust bar is waiting to see whether the Ninth Circuit will rethink its FTAIA interpretation and adopt an approach in line with the Second and Seventh Circuits.²² The Second Circuit's reasoned opinion in *Lotes* could provide the Ninth Circuit some of the justification it needs to do that.

⁹ *Lotes Co., Ltd.*, No. 13-2280, slip op. at 34.

¹⁰ *Id.*

¹¹ *Minn-Chem, Inc.*, 683 F.3d 845.

¹² *Lotes Co., Ltd.*, No. 13-2280, slip op. at 35-36.

¹³ "[The Sherman Act] shall not apply to conduct involving trade or commerce . . . with foreign nations unless . . . such effect gives rise to a claim under the provisions of [the Sherman Act]." 15 U.S.C. § 6(a)(2).

¹⁴ *Lotes Co., Ltd.*, No. 13-2280, slip op. at 47.

¹⁵ *Id.*

¹⁶ *Id.* at 48.

¹⁷ *Id.*

¹⁸ *Id.* at 46.

¹⁹ *Id.* at 43.

²⁰ *Id.* at 35-36.

²¹ *Id.* at 36-40.

²² *United States v. AU Optronics Corp.*, No. 12-10500 (9th Cir. argued Oct. 18, 2013).

How will the “reasonably proximate causal nexus” test be applied? Should the test adopted in *Lotes* become widely accepted, the next significant issue will be how the “reasonably proximate causal nexus” test is applied. In *Lotes*, the Second Circuit did not decide this “rather difficult question” because it disposed of the case on other grounds.²³ The court indicated that it views the “reasonably proximate causal nexus” question as a fluid one: courts will have to consider the structure of the market, the nature of the commercial relationships at each link in the causal chain, and use all of the traditional tools courts have used to analyze questions of proximate causation.²⁴ The Seventh Circuit is currently considering this question in the *Motorola Mobility LLC v. AU Optronics Corp.* case.²⁵ A Seventh Circuit panel recently held that there was no antitrust liability in the case where alleged price fixers of LCD panels sold them abroad to foreign companies, who then incorporated them into products that were exported to the U.S.²⁶ Since foreign action filtered through many layers, the Seventh Circuit found that any effect in the U.S. would be too indirect to have the necessary causal nexus.²⁷ The Seventh Circuit is considering rehearing the case en banc, however. Notably, several foreign competition authorities have submitted amicus briefs to the Seventh Circuit in opposition of the motion for rehearing en banc, raising concerns about potential overreaching of U.S. antitrust laws on foreign conduct. The Seventh Circuit has called for the views of the U.S. Solicitor General.

The “gives rise” limitation of the FTAIA is another way for companies to avoid antitrust liability: While most of the recent attention surrounding the FTAIA is appropriately around the interpretation of the “direct effect” prong, the importance of the “gives rise” element should not be overlooked. In *Lotes*, the Second Circuit reached its decision not to apply liability based on this element of the FTAIA and the Seventh Circuit’s *Motorola* decision cited the “gives rise” requirement as an alternate basis for avoiding liability. While the courts continue to refine the application of a “reasonably proximate causal nexus,” the “gives rise” limitation of the FTAIA may provide another barrier for the government, an individual, or a firm seeking to hold a company liable in the U.S. for foreign anticompetitive conduct.

²³ *Lotes Co., Ltd.*, No. 13-2280, slip op. at 45.

²⁴ *Id.* at 44.

²⁵ *Motorola Mobility LLC v. AU Optronics Corp.*, 746 F.3d 842 (7th Cir. 2014).

²⁶ *Id.* at 844.

²⁷ *Id.*

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