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Episode 8: The Foreign Trade Antitrust Improvements Act

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Audio Transcript

Today's episode will be of particular interest to companies based outside the United States and U.S. companies with operations outside the United States, because we'll be discussing a statute called the Foreign Trade Antitrust Improvements Act or FTAIA, for short.

The statute was enacted in response to uncertainty about when the Sherman Act could be applied to conduct that occurs outside the U.S. However, the uneven application of the FTAIA in U.S. courts has been confusing for businesses that need to know, as a practical matter, how and why their foreign trade could give rise to U.S. antitrust violation.

So, that's the question I wanted to explore today. And to do that, with me is Ian Papendick. Ian has lots of experience representing companies around the world in antitrust cartel litigations and government investigations.

Ian handles complex and class action litigation through all stages, from pleadings, discovery, through trials and appeals. And Ian joins us today to share his insights on the FTAIA and the extraterritorial reach of U.S. antitrust law. So, Ian, welcome to the podcast, and thanks for joining us.

Thank you for having me.

Of course. Well, to get started, can you give us a big picture overview of the FTAIA and what it aims to do?

Sure. So, as you mentioned, the FTAIA is a federal statute in the U.S. that was meant in part to resolve the question of when the Sherman Act can be applied to conduct that takes place overseas, meaning outside the U.S

The Sherman Act is the federal U.S. statute that, among other things, prohibits agreements that unreasonably restrain trade. And horizontal restraints, like price fixing agreements among competitors, are unlawful under the

Sherman Act. But also vertical restraints, like exclusive dealing arrangements between manufacturers and distributors, can also be deemed unlawful if they can unreasonably restrain trade.

And of course, the Sherman Act is used for both criminal and civil enforcement purposes. And personally, I've seen the FTAIA raised as a defense in many class actions and other private actions seeking damages for cartel behavior.

And how about mergers? Does the statute have any application there?

It does. The DOJ and the FTC in their Joint Antitrust Guidelines for International Enforcement and Cooperation, have said that they'll apply the same principles of the FTAIA's extraterritorial limitations when they make enforcement decisions concerning mergers or acquisitions involving foreign trade or commerce.

Okay, understood. Let's get into the language. What does the FTAIA say, just on its face?

So, the actual language of the statute is confusing, but I can break it down. What it basically says is that the Sherman Act cannot be applied to foreign trade unless the foreign trade either (1) counts as import commerce, or (2) has a direct, substantial, and reasonably perceivable effect on us commerce and the defendant's conduct gives rise to a Sherman Act claim.

This latter thing is called the "domestic effects test" or the "direct effects test." And there's also an export exclusion, which applies to export commerce from the U.S., but that's outside of what you wanted to focus on today, Molly.

Right. So, I did want to focus on what I'll call the first two prongs—import commerce or the "direct effects test" being the second prong. And both of those prongs have gotten confused. So, I've been thinking that the easiest way to try to explain the FTAIA's application might be through a hypothetical. So, Ian, can I give you some hypothetical facts and then you can give me your views on how they would shake out under the statue? Are you game for that?

Yep.

Okay. So, say there are competing leather producers in Europe. They get together and agree on the price of their leather that will be sold around the world. Company I is an Italian entity, and Company I is one of the conspirators. It ships all of its leather within Italy, but some of the leather is paid for by customers in the U.S., which Company I bills in the U.S. And leather, naturally, is a primary component in shoes. And let's say, shoes get made primarily in Italy and then are sold around the world, including to consumers here in the U.S. So, first, in terms of the FTAIA, can the DOJ bring charges against Company I under these facts?

Yes. I think you mentioned that Company I invoices customers in the U.S. for sales of price-fixed leather, and the shoes made from the price-fixed leather get sold all over the world, including the U.S. So that certainly could qualify under the FTAIA's domestic effects exception, or the import commerce exclusion, and the DOJ can prosecute Company I and its employees involved in the conspiracy.

It's also important to keep in mind that the DOJ may pursue an investigation and enforcement action, even where only a small portion of the defendant's overall global commerce touched on the U.S.

Okay. So, you said this situation could qualify under either prong, including the import commerce exclusion. So why don't you go ahead and tell us more about what the import commerce exclusion is?

Sure. So, there's no consensus over what the import commerce exclusion provided in the FTAIA means in all situations. But the classic example of import commerce is a transaction between an overseas defendant, alleged to have participated in a cartel, and a plaintiff purchaser in the United States.

In other words, let's say that Company I price fixed leather with its competitors in Italy, and then Company I itself sold leather to leather distributors operating in the U.S. That would be import commerce. But beyond the classic situation of the conspirator selling directly to a purchaser in the U.S., there's a lot of disagreement.

Some courts consider who imported the products to be relevant. So, some courts have said that if the conspirator first sells the product outside the U.S. and has nothing to do with its importation, that is not important commerce. But note that even in that situation, the domestic effects exception to the FTAIA could still apply to bring that conduct within the scope of the Sherman Act.

But other courts disagreed and have said that conduct involved import commerce if the conduct merely targets or is directed at a U.S. import market, even if the defendant—the conspirator—did not sell the product itself into the U.S. The DOJ has taken the position that where conspirators merely place the product into the distribution chain that eventually leads to the U.S., that can possibly count as import commerce.

So, the bottom line is that there's a risk that a U.S. court, in at least some jurisdictions, would say that if the conspiracy was directed at or otherwise discussed or targeted products destined for the U.S., it qualifies as import commerce and the Sherman Act can be applied.

All right, let's get back to the original hypothetical for a second. You said the DOJ could bring charges. What about the U.S. companies who were billed and paid for the leather? Can they bring Sherman Act claims against Company I?

Yes, they can.

And that's true even though the leather itself left Italy only after being transformed into a completely different finished product?

Yes. Let me explain a bit, as I said before, in response to your question about the DOJ, commerce and products that are (1) sold and shipped to customers in the U.S. as well as (2) products that are billed to customers in the U.S. but shipped elsewhere, and (3) products that are shipped to the U.S. but billed to entities outside the U.S., can be actionable.

So here, the leather was billed to U.S. customers, and that could be actionable under U.S. antitrust law and the FTAIA even if Company I actually delivered the products to an address in Italy. And when I'm saying "billed," I mean invoiced. The conspirators send the invoice for the products to a company in the U.S.

Okay, understood. Let me add some facts. What about a company in the United States that has Italian subsidiary or affiliates that makes shoes and those subsidiaries bought the price-fixed leather, and then made the shoes in Italy, or the U.S. company hired a third-party contract manufacturer in Italy to purchase the leather and manufacture the shoes on its behalf. But again, all of that activity takes place in Italy. Can that U.S. parent company sue Company I for the injury that its Italian affiliates or contract manufacturer incurred?

So, this is a trickier question and the devil is in the details. Some courts in the U.S. have indicated that this may be import commerce, if it was the purchaser that imported the product into the U.S. Other courts have indicated that it would not be import commerce if it was not the defendant itself that imported the products into the U.S.

So, claims based on that commerce would only be actionable if both the domestic effects exception test to the FTAIA and an exception to the rule against indirect purchaser claims—the *Illinois Brick* Doctrine—are met. And I'm sure that you, Molly, will cover or have covered the *Illinois Brick* Doctrine in another podcast. But as for the FTAIA, in practice, litigants will almost always argue that both import exclusion and the domestic effects exception are satisfied.

Okay. Well, good idea for an upcoming podcast episode about *Illinois Brick*. But for now, I want to get into the direct effects prong a little bit more. If you can tell me, big picture, what constitutes a "direct, substantial and reasonably foreseeable" effect on U.S. commerce that would satisfy this prong.

There is no consensus among courts of what the meaning of "direct" is. Some courts have held that an effect is direct if it follows is an immediate consequence of the defendant's activity, without deviation or interruption. And that's a quote from a Ninth Circuit case.

So arguably under this view, there cannot be a long chain of numerous intervening steps between the price-fixing conduct on the first sale, and its later entry into the United States. So, for example, an agreement between an American company and a foreign company to ban the foreign company from selling specially modified tomato seeds, did not have a direct effect on U.S. commerce under the FTAIA.

The U.S. government had challenged this agreement as illegal under Section 1 of the Sherman Act, alleging that it could possibly delay innovation. But the court found that the alleged injury was not the immediate consequence of the banned sale, because it was speculative and dependent on uncertain intervening development. And ultimately, there may not be any new innovations. And that's the Ninth Circuit case that I was quoting from earlier, which is called *LSL Biotechnologies*.

Courts in other circuits have used a broader "proximate causation" standard, which allows for more conduct to have a direct effect. This is a quote from a case: "Direct means that the injury is within the reasonably proximate causal nexus of the anti-competitive behavior." And there are a couple of courts, in the Seventh Circuit and Second Circuit, that apply this standard or a similar standard. And under this view, as long as the entry into the United States is "reasonably" close in time or circumstance to the initial sale of the price-fixed good overseas, the later sale in the United States is within the reach of the Sherman Act without any "immediacy" necessary. And the DOJ also supports this standard.

So, let's move on to the terms of "substantial" in the direct effects test. What does "substantial" mean according to courts in this context?

FTAIA cases don't generally turn on the question of how substantial the effect must be. However, courts have addressed the substantial prong in cases involving price-fixed components of consumer products when considering the relative cost of the component as a percentage of the finished electronic product's cost.

For example, in the *Capacitors* antitrust litigation, the court observed that "capacitors are tiny parts that cost pennies or less to buy and are unlikely to be a substantial cost component of finished products, even when used in volume." That's a quote from a decision in the *Capacitors* case.

In contrast, in discussing the LCD panels cartel, the court noted that the screens were substantial costs of the computers and phones in which they were installed. And it was well understood by the conspirators that substantial numbers of these finished products were to be shipped to the United States at inflated prices. And for the purposes of the hypothetical we've been talking about, I don't know if the cost of leather relative to the cost of a finished shoe.

That's okay. I won't ask you that. So let's turn now to "reasonable foreseeability." What does that mean?

This is another one that hasn't been litigated much, given the overlap with the question of a direct effect. The DOJ and FTC have explained that they view this language as requiring an objective test, so that they may still investigate or prosecute even if the defendant didn't actually know—meaning they didn't subjectively know or care—whether it's products were shipped to the United States.

Courts have similarly found that the question is whether the alleged domestic effect would have been evident to a reasonable person making a practical business judgment. Or, as one court explained, "The effect is reasonably foreseeable if it is the rational expected outcome of the conduct that's been challenged."

However, a Special Master in the *Capacitors* case recently suggested that there's a *mens rea* requirement, meaning that it must be reasonably perceivable to a defendant that its sale of goods at artificially inflated prices would be shipped to the United States, where there will be effects on U.S. commerce. So, the bottom line is that there's no clear answer to this question.

Okay. And the judge in the *Capacitors* case hasn't yet given his opinion on that Special Master's conclusion, is that right?

That's right. It'll be very interesting to see if he rules that this subjective knowledge requirement is in the FTAIA.

Right. Okay. So, let's shift now to the "gives rise to" prong of the direct effects test. You said that the direct effect on U.S. commerce has to "give rise to" the Sherman Act claim. What does "gives rise to" mean?

So, on the private side, first of all, it has to be the plaintiff's actual claim and not just some generic claim that that did not harm the actual plaintiff. And harm to a plaintiff's foreign subsidiary might not be sufficient in a civil case for example. And the plaintiff's claim must be based on anti-competitive effects in the United States, which can make it hard for a foreign plaintiff or a foreign subsidiary of a U.S. company to satisfy the domestic effects exception.

For example, leather suppliers around the world form a global price-fixing conspiracy, that raises prices for leather sold in the U.S., but also independently raises prices for leather sold across Europe. The plaintiff who purchased leather in the U.S. could bring a claim under the Sherman Act. But a company that purchased leather in Europe could not bring a Sherman Act claim based on the harm that it suffered by paying an overcharge on that Italian leather in Italy.

The Supreme court has held that a foreign company cannot bring a U.S. antitrust claim for purchases outside the U.S., unless it can also show that there was a U.S. domestic effect—higher U.S. prices—that are the basis of the harm suffered by paying higher prices abroad.

So, under the standard, several courts have rejected theories based on global pricing by a defendant, argued by plaintiffs who alleged global conspiracies, even where plaintiff's U.S. pricing team allegedly negotiated a global price for its U.S. purchases as well as its foreign affiliates' purchases abroad. The effects in the U.S. do not necessarily "give rise to" claims based on foreign purchases, if that makes sense.

It does. I have another question going back to my original hypothetical. I'm wondering now whether a class of consumers who indirectly purchased leather shoes in the United States(they did not buy the leather itself at all), could they bring, let's say injunctive relief claims against Company I under the Sherman Act or damages claims under state laws, even if the leather shoes they bought were first sold in Italy?

So, there's some uncertainly about this. The courts have found that indirect purchaser plaintiffs are not barred from bringing these types of claims, even where the price-fixed products were made and first sold outside the U.S., but it's a harder claim to prevail on.

Okay. Before we wrap up, I want to turn to timing considerations. When a case involves foreign conduct and foreign commerce, as a practical matter, when would a defendant raise the FTAIA as a defense?

Application of the FTAIA can involve very a fact-intensive inquiry. So generally, defendants will raise it on summary judgment after there's been some discovery. But defendants do sometimes seek to raise it early in the case by moving for early partial summary judgment, to try to exclude certain categories of foreign commerce because it can significantly narrow the damages claims at issue.

The judge in the *Capacitors* case, for example, took this approach in an attempt to narrow the scope of the claims that would have to be looked at for purposes of class certification. And there was also a decision recently affirmed by the Second Circuit where the FTAIA issue was determined even earlier, at the motion to dismiss stage.

In that case, the Second Circuit concluded that the plaintiff had not plausibly alleged that the defendant's alleged conduct in Russia fell within the exception for conduct involving import commerce, and the claim was dismissed. So, unfortunately there's no simple answer as to when it is best raised. It's a case-by-case analysis.

Okay. As is all of this, it sounds like, but I want to thank you. And I appreciate you going along with my hypothetical. That's all the time we have for this episode. But I think this has been really useful for lawyers and companies to think about.

It's been my pleasure. And if you hear of any Italian leather conspiracies, please give me a ring. I know these are complicated issues, and the stakes are very high for companies. And as we discussed, there's substantial uncertainty in this area, which is because the law remains in flux. So, it is a case-by-case analysis and that needs to be done properly to assess the risks involved in any given situation.

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