Motorola Mobility and the FTAIA: A Deterrence-Based Definition of "Direct" Effect[1]

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In *Motorola Mobility LLC v. AU Optronics*, No. 14-8003, 2014 WL 1243797 (7th Cir. Mar. 27, 2014), the Seventh Circuit Court of Appeals offers an interpretation of the Foreign Trade Antitrust Improvements Act (FTAIA), 15 U.S.C. §6a that would have significant implications for the right to sue foreign companies under the Sherman Act. Here, we offer a different interpretation that is grounded in the objective of deterring harm to U.S. commerce.

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:[2]

[1] 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*, No. 14-8003, 2014 WL 1243797 (7th Cir. Mar. 27, 2014), pp. 4-5.

> 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"[3] which is a term used in *Minn-Chem, Inc. v. Agrium, Inc.,*" 683 F.3d 845 (7th Cir. 2012). The *Minn-Chem* decision drew upon the Ninth Circuit Court when it said that "direct" means that "it follows as an immediate consequence of the defendant's activity."[4] and that an effect is not direct when "it depends on … uncertain intervening developments."[5] In connection with the *Minn-Chem* decision, an *Amicus Curiae* Brief submitted to the Seventh Circuit[6] interpreted "direct" as "reasonably proximate."

Focusing on what it means to be "remote" or "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 then 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.

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[3] Ibid, p. 4.
[4] *United States v. LSL Biotechs.*, 379 F.3d 672, 680 (9th Cir. 2004)
[5] Ibid at 681.
[6] "Brief for the United States and the Federal Trade Commission as *Amici Curiae* in Support of Neither Party on Rehearing *En Banc*," January 12, 2012; p. 8.

The FTAIA seeks to balance comity and the protection of U.S. commerce; that the U.S. 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 anti-competitive 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 anti-competitive behavior than to *ex post* disrupt and punish anti-competitive 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.

What is necessary to deter companies from engaging in anti-competitive 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 believes that it is more likely to be found liable if its conduct causes harm than when it does not. Deterrence then requires that liability is 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.

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 was aware that its actions would create harm but rather that it should have been 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*, 379 F.3d (at 698) 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 U.S. then they could not reasonably foresee 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 U.S. In this scenario, a cartel among LCD panel manufacturers would have had a direct but not reasonably foreseeable harmful effect on U.S. commerce.

By comparison, the definition of "direct" used by the Seventh Circuit in *Motorola Mobility* does not satisfy the goal of deterrence, for 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. 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 knew 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.

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 U.S. The manufacturers sell the products at collusive prices to the exporting companies who then sell them in the U.S. 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.

Let me next dispense with an alternative interpretation of "direct" to that proposed here, which is that the FTAIA meant it 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 Co. v. Illinois* 431 U.S. 720 (1977), presumably the act would have specifically referred to direct purchasers. Nor do I think it is appropriate to ascribe this interpretation to the Seventh Circuit. Again, if that was 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 was 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.

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:[7]

> [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.

In conclusion, it has been argued that it follows from the objective of the FTAIA to deter foreign companies from inflicting anti-competitive harm on U.S. commerce that foreign companies should be held liable for conduct for which they should have anticipated that it would cause harm (that is, it is "reasonably foreseeable") and for which it can be determined that the observed harm was caused by the conduct of those companies (that is, it is "direct").

[7] "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.