Second Circuit Weighs In On Extraterritorial Reach of U.S. Antitrust Law

On June 4, 2014, in *Lotes Co., Ltd.* v. *Hon Hai Precision Co.*, the U.S. Court of Appeals for the Second Circuit concluded that the requirements of the Foreign Trade Antitrust Improvements Act ("FTAIA"), a law that defines the extraterritorial reach of U.S. antitrust law, are "substantive and nonjurisdictional," going to the merits of the claim rather than the adjudicative power of the court, which has significant, but mostly procedural effects.[1] In addition, the decision, authored by Judge Katzmann, clarified that in the Second Circuit, foreign anticompetitive conduct has the requisite "direct, substantial, and reasonably foreseeable effect" on U.S. commerce needed to give rise to an antitrust claim where there is a "reasonably proximate causal nexus" between the alleged foreign conduct and the harm to U.S. commerce, disagreeing with the Ninth Circuit's more stringent standard.[2] The court declined to apply the "causal nexus" standard to the facts of the case because the plaintiff did not meet a second, independent prong of the FTAIA.

I. Background and Procedural History

The dispute concerned the development of the latest industry standard for Universal Serial Bus ("USB") connectors. Lotes Co., Ltd., a Taiwanese designer and manufacturer of electronic components, including USB connectors, alleged that Foxconn and other manufacturers of USB connectors attempted to gain control of a new technological standard for USB connectors (USB 3.0) and to monopolize the USB connector industry in violation of Sections 1 and 2 of the Sherman Act. Lotes claimed that the defendants violated commitments they made to a USB-standard setting organization to offer licenses on reasonable and nondiscriminatory ("RAND") terms by filing patent infringements suits in China against two Chinese subsidiaries of Lotes.

The defendants moved to dismiss the claim and the district court dismissed for lack of subject matter jurisdiction under the FTAIA. The FTAIA brings wholly foreign conduct within the statute's scope where (1) the foreign conduct has a "direct . . . effect" on U.S. domestic commerce, and (2) that effect "gives rise to a claim under" the Sherman Act. The district court further ruled that Lotes's Sherman Act claims were barred under the domestic effects test of the FTAIA because Lotes failed to plausibly allege that defendants' conduct had a "direct, substantial, and reasonably foreseeable effect" on U.S. domestic or import commerce.[3] A three-judge panel of the Second Circuit affirmed on alternative grounds.[4]

II. The Court's Decision

The Second Circuit first addressed whether the FTAIA requirements are jurisdictional or substantive in nature. In light of *Arbaugh* v. *Y & H Corp.*,[5] and its progeny, the court concluded that the requirements of the FTAIA "go to the merits of an antitrust claim rather than to subject matter jurisdiction" and thus overruled its previous *Filetech* decision.[6] Because the court held the requirements to be nonjurisdictional, it addressed the issue of whether defendants contractually waived those requirements. The court ruled that defendants did not waive the FTAIA requirements because Lotes failed to raise it before the district court and the cited contractual

[1] No. 13-2280, 2014 WL 2487188 at *1 (2d Cir. June 4, 2014).
[2] *Id.*
[3] *Id.* at *6.
[4] *Id.* at *18.
[5] 546 U.S. 500 (2006).
[6] *Lotes Co., Ltd.* v. *Hon Hai Precision Co*., 2014 WL 2487188 at *8 (citing *Filetech S.A.* v. *France Telecom S.A.*, 157 F.3d 922 (2d Cir. 1998)).

provisions did not suggest that a waiver took place. The court emphasized that the contractual agreements merely affirmed "that the defendants must abide by the Sherman Act to the extent it properly applies."[7]

The appellate court then addressed whether Lotes plausibly alleged that the defendants' conduct had a "direct, substantial, and reasonably foreseeable effect" on U.S. domestic or import commerce under the FTAIA.[8] The appellate court determined that the district court erred by misinterpreting the statute, disapproving of the lower court's reliance on the Ninth Circuit's decision in *United States* v. *LSL Biotechnologies*, which found that "an effect is 'direct' if it follows as an immediate consequence of the defendant's activity."[9] The Second Circuit instead adopted the Seventh Circuit's approach in *Minn-Chem* v. *Agrium, Inc.*, which interprets the term "direct" to require "a reasonably proximate causal nexus."[10] Although it declined to decide the question of whether the "direct . . . effect" test was met, the appellate court criticized the lower court for putting "near-dispositive weight on the fact that USB 3.0 connectors are manufactured and assembled into finished computer products '*in China*' before being sold in the United States," noting that "[t]his kind of complex manufacturing process is increasingly common in our modern global economy" and that "[t]here is nothing inherent in the nature of outsourcing or international supply chains that necessarily prevents the transmission of anticompetitive harms or renders any and all domestic effects impermissibly remote and indirect."[11]

The court found that Lotes's Sherman Act claims were barred in any event -- under the second prong of the FTAIA standard -- because any "domestic effect caused by the defendants' foreign anticompetitive conduct did not 'give[ ] rise to' Lotes's claims."[12] The Second Circuit noted the trend in other circuits to conclude that "the domestic effect must proximately cause the plaintiff's injury" and adopted the same standard,[13] determining that the defendants' anticompetitive conduct did not proximately cause Lotes's injury. Although Lotes alleged that the defendants' conduct drove up prices of electronics incorporating USB 3.0 connectors in the United States, the court noted that "those higher prices did not cause Lotes's injury of being excluded from the market for USB 3.0 connectors."[14] The court emphasized that Lotes's injury "flowed directly from the defendants' exclusionary foreign conduct."[15] Because Congress did not intend for the FTAIA's exception to bring "independently caused foreign injury" within the reach of the Sherman Act, the court found that Lotes could not seek redress under that law.[16]

The appellate court therefore affirmed the lower court's ruling that the FTAIA barred Lotes's claims on the ground that any domestic effect of defendants' foreign anticompetitive conduct did not "give[ ] rise to" Lotes's Sherman Act claims.[17]

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[7] *Id.* at *12.
[8] *Id.* at *12-13.
[9] 379 F.3d 672, 680 (9th Cir. 2004).
[10] 683 F.3d 845, 857 (7th Cir. 2012) (en banc).
[11] *Lotes*, 2014 WL 2487188 at *15.
[12] *Id.* at *16.
[13] *See, e.g., 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); *Empagram S.A.* v. *F. Hoffmann-LaRoche Ltd.*, 417 F.3d 1267, 1271 (D.C. Cir. 2005).
[14] *Lotes*, at *17.
[15] *Id.*
[16] *Id.*
[17] *Id.* at *16.

III. Significance of the Decision

The Second Circuit's *Lotes* decision overrules its prior decision *Filetech S.A.* v. *France Telecom S.A.*, to the extent that case interpreted the FTAIA's requirements as jurisdictional. As a result, a party contesting the extraterritoriality of an antitrust claim must make a motion to dismiss for failure to state a claim (Federal Rule of Civil Procedure 12(b)(6)), rather than make a motion to dismiss for lack of jurisdiction (12(b)(1)). This affects when a party may raise the issue, as challenges to subject matter jurisdiction can be brought at any time but motions for failure to state a claim must be brought earlier in the litigation, as well as how the court will handle the disputed facts, as on a 12(b)(6) motion to dismiss, factual allegations contained in the complaint are accepted as true. Further, in requiring a proximate causal nexus between the alleged foreign conduct and the effect on U.S. commerce, the Second Circuit characterized its approach as "less stringent"[18] than the Ninth Circuit's interpretation in *United States* v. *LSL Biotechnologies*, where the Ninth Circuit found that the effect is direct if it "follows as an immediate consequence."[19]

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If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or e-mail Elai Katz at (212) 701-3039 or ekatz@cahill.com; or Jamie Gottlieb at (212) 701-3138 or jgottlieb@cahill.com.

[18] *Id.* at *13.

[19] 379 F.3d at 680.

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