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FTAIA

David Barth  
Bates White Economic Consulting

## Deterrence and Efficiency Considerations Warrant an Expansive Reading of the FTAIA

David Barth<sup>1</sup>

### I. INTRODUCTION

The Foreign Trade Antitrust Improvement Act of 1982 (“FTAIA”) is an area of antitrust law in which courts’ rulings have been unpredictable. Consider two recent cases in the Seventh Circuit: *Minn-Chem, Inc. v. Agrium, Inc.*, and *Motorola Mobility LLC v. AUO Optonics Corp.* In *Minn-Chem*, the District Court denied defendants’ motion to dismiss on FTAIA–related grounds. Next, a three-judge appellate panel overturned that ruling and granted defendants’ motion. Then, the Seventh Circuit sitting *en banc* affirmed the District Court’s ruling and denied defendants’ motion.

Similarly, in *Motorola*, the MDL court in the Ninth Circuit denied defendants’ motion for summary judgment for certain categories of allegedly foreign purchases. When the case was remanded for trial, defendants moved for reconsideration. The District Court granted that motion and granted partial summary judgment for defendants, removing about 99 percent of Motorola’s claimed purchases from the case. An appellate panel affirmed that ruling, but it did so with a decision that, according to the U.S. government, conflicts with the *en banc* decision in *Minn-Chem*.<sup>2</sup> After further developments in the case, the panel vacated its decision and accepted the appeal for argument on the merits.<sup>3</sup> So *Motorola* is once again before an appellate panel.

The vacated *Motorola* panel decision appears to have been an attempt to rule in a way that would add predictability to future cases involving the FTAIA. The decision set clear boundaries that would benefit defendants in future U.S. cases against international cartels.<sup>4</sup> Now that the decision has been vacated, there are a number of ways the panel could rule. I believe a ruling benefiting defendants and exempting any of Motorola’s purchases from U.S. antitrust law before trial is undesirable as a matter of economic policy: It would increase the incentives foreign firms have to engage in cartel behavior in global markets, and it would create new incentives to change otherwise efficient supply chain behavior.

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<sup>1</sup>David Barth, Ph.D, is a Principal at Bates White Economic Consulting LLC. He can be reached at david.barth@bateswhite.com. I thank John Asker, Atur Desai, Jonathan Eaton, Joseph Harrington, James Martin, Charles Miller, Roger Noll, Ariel Pakes, and Robert Porter for conversations which influenced my thinking on this topic.

<sup>2</sup> Brief for the United States and the Federal Trade Commission As Amici Curiae in Support of Panel Rehearing or Rehearing *En Banc*, 7 (April 24, 2014).

<sup>3</sup> The panel’s ruling not only accepted the matter for appeal but also decided it on the merits absent any briefing on the merits. The procedural history of the case through early July is described in Petition For Hearing *En Banc* Of Motorola Mobility, LLC, 1-7 (July 9, 2014).

<sup>4</sup> Melissa Lipman, *7th Circ. FTAIA Ruling Curtails US Antitrust Reach*, LAW360 (April 1, 2014), and Alex Bourelly & Noah Mink, *7th Circ. Ruling May Restrict International Cartel Enforcement*, LAW360 (April 15, 2014).

## II. INTERNATIONAL CARTELS ARE INSUFFICIENTLY DETERRED

Hard-core, or secret, cartels are undesirable. The Organisation for Economic Co-operation and Development describes such cartels as “the most egregious violations of competition law.”<sup>5</sup> The OECD also notes that such cartels are “are condemned in all competition laws.”<sup>6</sup> The International Competition Network describes such cartels as “a direct assault on the principles of competition.”<sup>7</sup> Both the OECD and the ICN say such cartels are “universally recognised as the most harmful of all types of anticompetitive conduct.”<sup>8</sup> In one of its *Motorola* amicus briefs, the U.S. Government stated, “a global effort against hard core cartels, like the LCD price-fixing cartel, has emerged.”<sup>9</sup>

Hence, potential cartels must be deterred from forming, or else cartels will continue to form and inflict harm on consumers.<sup>10</sup> Focusing on deterrence of potential cartels is appropriate because some cartels will manage to escape detection and punishment, making their secret illegal actions profitable after the fact. Cartels will be deterred from forming in the first place if the product of the probability of catching the cartel and the penalties if caught outweigh the anticipated financial benefits. If potential cartel members will not find it profitable to form a cartel, then they will not do so, and cartels will be effectively deterred.<sup>11</sup>

Deterrence is a difficult issue when considering global markets. For a cartel to effectively fix prices in a global market, it must raise prices worldwide. If it failed to raise U.S. prices, product would flow out of the United States to constrain the rise in non-U.S. prices.<sup>12</sup> This is notably an issue for cartels facing U.S.-based multinational buyers in a global market. U.S.-based multinational buyers have the information needed to resist attempts to increase non-U.S. prices relative to U.S. prices. Potential cartels facing this situation are likely to form and raise prices across the globe, including in the United States, or not form at all.

If non-U.S. competition authorities and legal systems fail to collectively impose adequate sanctions on international cartels operating in global markets, international cartels may decide to form and may operate profitably, even after considering the sanctions they expect to pay in the United States. The evidence shows this is more than a theoretical concern—actual sanctions are currently inadequate to deter the formation of international cartels. Connor studied 260 international cartels discovered between 1990 and mid-2005. While he reports the median U.S.

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<sup>5</sup> OECD, *Hard Core Cartels: Recommendation of the Council Concerning Effective Action Against Hard Core Cartels*, I (1998).

<sup>6</sup> OECD, *Fighting Hard Core Cartels: Harm, Effective Sanctions and Leniency Programmes*, 75 (2002).

<sup>7</sup> ICN, *Defining Hard Core Cartel Conduct, Effective Institutions, Effective Penalties*, 1 BUILDING BLOCKS FOR EFFECTIVE ANTI-CARTEL REGIMES, 1 (2005).

<sup>8</sup> OECD, *supra* note 6, at 75; ICN, *supra* note 7, at 1.

<sup>9</sup> Supplemental Brief for the United States as Amicus Curiae, at 6 (June 27, 2014).

<sup>10</sup> In the following, the shorthand “cartels” refers to hard-core, or secret, cartels.

<sup>11</sup> Other approaches can contribute to effective deterrence as well. Leniency programs, the threat of incarceration, and other approaches can create conflicting incentives among the cartelists and the individuals responsible for cartel activity. Cartels are unable to resolve these conflicting incentives via contracts, even when it would be jointly profitable to do so, as such contracts would be part of the cartel agreement, and hence illegal and unenforceable.

<sup>12</sup> The cartel might be able to raise non-U.S. prices by the amount of tariffs and transportation costs from the United States.

sanctions on such cartels exceed overcharges in the United States, the median ratio of total global sanctions to global overcharges was 42.3 percent among cartels that fixed prices on two or more continents.<sup>13</sup> More than half of detected global cartels kept more than 50 cents on every dollar of their overcharges, even after paying penalties. Eleanor Fox is right to be concerned that “global cartels’ profits from sales outside of America may overwhelm losses from damages on sales within.”<sup>14</sup>

Of course, not all cartels are caught and punished. Measured detection rates in the academic literature are well below 100 percent.<sup>15</sup> So the measurable financial rewards to cartel behavior are, by definition, understated, while the measurable financial penalties are correctly stated. Potential cartelists have an even stronger financial incentive to engage in illegal activity than that measured by Connor.

Further evidence that deterrence of international cartels is inadequate in practice is seen in corporate actions. Many companies caught participating in international cartels are serial offenders. These companies repeatedly form and participate in cartels, so they are apparently not deterred by current enforcement policy. For example, many of the LCDs cartel members are serial offenders, including Hitachi, LG, and Samsung.<sup>16</sup>

### III. SUPPLY CHAINS SHOULD BE ORGANIZED TO MAXIMIZE EFFICIENCY, NOT LEGAL GAINS

Many goods are produced in geographically concentrated regions, and this concentration occurs for a number of beneficial reasons. For example, external economies of scale can lead production to efficiently concentrate in one region.<sup>17</sup> In other cases, knowledge spillovers may tend to create incentives to geographically co-locate and capture synergies.<sup>18</sup>

International supply chains are organized in such a manner so as to capture these benefits. For instance, research has shown that foreign countries with lower costs and export-friendly policies have greater exports to U.S. multinational parents via their foreign affiliates.<sup>19</sup>

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<sup>13</sup> John Connor, *Effectiveness of Antitrust Sanctions on Modern International Cartels*, 6 J. INDUSTRY, COMPETITION & TRADE 212 (2006). These global cartels’ price-fixing activities generally impacted the United States, as “many operated in as many as six continents, but most fixed prices in the ‘Triad’ of Western Europe, North America, and East Asia.” *Id.* at 199.

<sup>14</sup> Eleanor Fox, testimony before the Antitrust Modernization Commission, 11 (Feb. 15, 2006).

<sup>15</sup> Peter Bryant & E. Woodrow Eckard, *Price Fixing: The Probability of Getting Caught*, 73 REV. ECON. & STATISTICS, 531-536 (1991); Emmanuel Combe, Constance Monnier, & Renaud Legal, *Cartels: The Probability of Getting Caught in the European Union*, Bruges European Economic Research Paper 12 (2008); and Peter Ormosi, *A Tip of the Iceberg? The Probability of Catching Cartels*, 29 J. APPLIED ECONOMETRICS 549-566 (2014). The effects of the U.S. leniency program on detection rates are measured in Nathan Miller, *Strategic Leniency and Cartel Enforcement*, AMER. ECON. REV. 750-768 (2009).

<sup>16</sup> Roger Noll describes the overlap of companies and even employees involved in the various electronics cartels. Roger Noll, *The DRAM Antitrust Litigation*, THE ANTITRUST REVOLUTION, 6<sup>th</sup> ed. (John Kwoka, Jr. & Lawrence White, eds. 2013).

<sup>17</sup> Paul Krugman, *Increasing Returns and Economic Geography*, 99 J. POLITICAL ECON. 483-499 (1991).

<sup>18</sup> Gregory Tasse, *Competing in Advanced Manufacturing: The Need for Improved Growth Models and Policies*, 28 J. ECON. PERSPECTIVES 27-48 at 30 (2014).

<sup>19</sup> Gordon Hanson, Raymond Mataloni Jr., & Matthew Slaughter, *Vertical Production Networks in Multinational Firms*, 87 REV. ECON & STATISTICS 664-678 (2005).

#### IV. ECONOMIC CONSIDERATIONS PUSH FOR AN EXPANSIVE READING OF THE FTAIA

A policy that exempts purchases by foreign subsidiaries of U.S. multinational parents from the reach of private actions under U.S. antitrust law is likely to make U.S. consumers worse off.

First, such a policy would decrease deterrence of international cartels that affect U.S. consumers. International cartels are already inadequately deterred. In Motorola's case, removing 99 percent of its purchases from the reach of private enforcement of U.S. antitrust laws would likely make the LCDs cartel's decision to conspire against Motorola (and any similarly situated purchasers) financially beneficial. If Motorola proceeded to trial in the United States with only 1 percent of its purchases at issue, prevailed in totality, and received treble damages, the cartel would keep approximately 97 percent of the profits it made from conspiring against Motorola. Therefore, unless the cartel members paid government fines (or private damages in other venues) collectively equal to nearly all of their collusive gains, the cartel members would wind up benefitting from their conspiracy as far as sales to Motorola were concerned. As Connor's numbers indicate, it is unlikely government fines and private damages in other venues would be this large.

Second, such a policy would create incentives to distort supply chains of U.S.-based multinational buyers. For legal reasons, a U.S.-based multinational purchaser would face a new incentive to reorganize its supply chain to change the purchaser to the U.S. multinational parent and the delivery location to the United States. This would result in the loss of benefits from locating near key foreign suppliers. U.S. companies would face a new incentive to keep production in the United States, even when it would otherwise be efficient to move it offshore.

Foreign countries would likewise face an incentive to permit cartel formation to attract business to that nation.<sup>20</sup> These cartels would then be able to exploit any supply chains that had not changed by selling to foreign subsidiaries unable to pursue an antitrust claim in U.S. courts. Cartels would also have incentives to focus on making sales to counter-parties known to lack claims under U.S. antitrust law.

#### V. CONCLUSION

Courts, lawyers, and economists will continue to attempt to provide meaning to the language of the FTAIA. The vacated panel decision emphasized comity considerations and formalistic distinctions in construing the language of the statute. But a decision which promotes comity considerations and formalistic distinctions above economic considerations will come at the expense of U.S. consumers in the future.

International cartels are recognized throughout the globe as undesirable. Yet they are inadequately deterred. International cartels often appear profitable, even after being caught. Many companies are serial offenders. Moreover, supply chains are organized in ways to

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<sup>20</sup> Kathryn McMahon, *Competition Law and Developing Economies: Between 'Informed Divergence' and International Convergence*, in RESEARCH HANDBOOK ON INTERNATIONAL COMPETITION LAW, 231 (Ariel Ezrachi, ed. 2012); and Paul Victor, *Export Cartels: An Idea Whose Time Has Passed*, 60 ANTITRUST L.J. 571-581 at 571 (1991).

maximize efficiencies. Rules that create safe harbors for cartel members are likely to have adverse effects on efficient supply chains.

Both deterrence and supply chain considerations push for an expansive reading of the FTAIA—one that subjects foreign cartels to greater liability for their illegal actions, not less—and counsel for a decision allowing Motorola to pursue all its claims at trial.

To reach such a decision, the Court should focus attention on functional economic considerations, such as how Motorola’s supply chain operated and how defendants’ conduct toward Motorola impacted U.S. commerce. Given Motorola’s allegations, its claims should meet the requirements of an expansively-read FTAIA and should be allowed to proceed to trial for a jury to hear.<sup>21</sup>

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<sup>21</sup> Motorola’s allegations are described in Appellant’s Opening Brief (Aug. 29, 2014). For example, Motorola alleges it “there was an *actual single price* set in the United States between defendants and the U.S. company, and that price was applied *as such* to the rest of Motorola’s global supply chain.” *Id.* at 49 (emphasis in original). If true, the LCD cartel necessarily increased the prices of all of Motorola’s panel purchases with the same conduct, regardless of (a) where the panels were delivered, (b) what happened to the panels after delivery, and (c) where a consumer ultimately took possession of a phone.