The Empagran Exception: Between Illinois Brick and a Hard Place

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The Empagran Exception: Between Illinois Brick and a Hard Place

Victor P. Goldberg

Before it was uncovered and prosecuted, the international vitamin cartel, known as “Vitamins, Inc.” by its perpetrators, was extraordinarily successful. Estimates of cartel profits ran as high as $18 billion (in 2003 dollars).\(^1\) In addition to substantial criminal sanctions, cartel members paid over $2 billion to American plaintiffs.\(^2\) When foreign plaintiffs tried to sue the foreign defendants in American courts, however, they encountered resistance.\(^3\) A trial court read the Foreign Trade Antitrust Improvements Act (“FTAIA”) to restrict the reach of the Sherman Act and preclude the foreigners from suing foreigners.\(^4\) The D.C. Circuit reversed, holding that the facts brought the case within FTAIA’s exceptions.\(^5\) There already being a circuit split with the Second Circuit allowing a suit\(^6\) and the Fifth Circuit dismissing one for lack of subject matter jurisdiction,\(^7\) the Supreme Court granted certiorari. In its unanimous decision, the Court ruled that the FTAIA exception did not apply where a claim rested solely on foreign harm that was independent of any adverse domestic affect.\(^8\)

The Foreign Trade Antitrust Improvements Act of 1982 excludes most anti-competitive foreign trade and commercial activity from the Sherman Act’s reach.\(^9\) However, the FTAIA also contains exceptions to this general rule, using language that is less than clear:

[The Sherman Act] shall not apply to conduct involving trade or commerce (other than import trade or import commerce) with foreign nations unless—

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\(^2\) Amici for the defendants reckoned the total financial antitrust fines and penalties imposed on the cartel as between $4.4 and $5.6 billion. Brief Amici Curiae of Professors Darren Bush et al. in Support of Respondents, note 5, at 15, Empagran, 542 U.S. 155 (No. 03-724), 2004 WL 533933.

\(^3\) Plaintiffs included five foreign vitamin distributors located in Ukraine, Australia, Ecuador, and Panama.


\(^6\) Kruman v. Christie’s Int’l, 284 F.3d 384 (2d Cir. 2002).

\(^7\) Den Norske Stats Oljeselskap As v. HeereMac Vof, 241 F.3d 420 (5th Cir. 2001).


(1) such conduct has a direct, substantial, and reasonably foreseeable effect—

(A) on trade or commerce which is not trade or commerce with foreign nations, or on import trade or import commerce with foreign nations . . . and

(2) such effect gives rise to a claim under the provisions of [the Sherman Act].

The Court interpreted the FTAIA as barring the foreign plaintiffs’ suit. However, it remanded the case for consideration of plaintiff’s alternative theory that the foreign injury was not independent of the adverse domestic effect. The Supreme Court thereby left future foreign plaintiffs with some wiggle room, but little guidance.10 The alternative theory was also rejected on remand.11 Subsequent plaintiffs have fared similarly, with only one reported decision of a suit (involving price fixing of computer components) surviving a motion to dismiss.12 Even if a cartel’s domestic price-fixing could only be sustained if it operated both domestically and abroad, that would not be sufficient to allow foreign plaintiffs to sue foreign sellers in the U.S..

If not then, are there any circumstances that would fall within the FTAIA exception? In this article, I identify one narrow class of cases that would satisfy the statutory exception. Rather than focusing on the interrelatedness of the foreign and domestic prices, the inquiry centers on the resale of goods to the domestic market. The argument, raised by Justice Scalia at oral argument, is a variant on Illinois Brick, the Supreme Court’s landmark ruling rejecting a passing-on theory of injury suffered by indirect purchasers.13 Before developing this argument in Section II, I first briefly detail the Empagran decisions.

I. Empagran and the FTAIA

During the Empagran litigation, it was undisputed that the domestic and foreign vitamin markets were interrelated.14 Vitamins, Inc. could not operate solely within the U.S. while leaving foreign markets competitive. Nor could it cartelize foreign markets alone.15 Be-

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10 Empagran, 542 U.S. at 175.
14 At oral argument, plaintiff’s counsel asserted: “Now, the reason our position is critical is the one identified by Justice Kennedy, and that is that the conspirators' cartel encompassed a worldwide market for bulk vitamins and the worldwide market is relevant because geographic boundaries don't have any meaning here. A conspiracy limited to U.S. commerce would have collapsed as U.S. purchasers bought abroad, as Justice Scalia has said.” Oral Argument at 19, F. Hoffman-La Roche Ltd. v. Empagran S.A., 542 U.S. 155 (2004) (No. 03-724). 2004 WL 1047902 (U.S.), 41 USLW 3686.
15 Like love and marriage or a horse and carriage, you can’t have one without the other. See Sammy Cahn and Jimmy Van Heusen, “Love and Marriage” (1958).
cause of the minimal transportation cost, low trade barriers, and fungibility of vitamins, a single market for these goods emerged; had the conspiracy been confined to a single geographic submarket, it would have been doomed by arbitrage. The plaintiffs argued, and D.C. Circuit on its initial hearing of the case, agreed that this interrelationship was sufficient to bring the cartel within the FTAIA exception. The conspiracy itself had (1) “a direct, substantial, and reasonably foreseeable effect” on domestic competition and (2) this effect (the injured domestic customer) “[gave] rise to” a Sherman Act claim.

Although the Supreme Court accepted the interrelationship argument, its framing of the issue made clear that this was insufficient to find an FTAIA exception. “The price-fixing conduct significantly and adversely affects both customers outside the United States and customers within the United States, but the adverse foreign effect is independent of any adverse domestic effect. In these circumstances, we find that the FTAIA exception does not apply (and thus the Sherman Act does not apply).”

The Court’s primary justification for this conclusion was prescriptive comity, a rule of construction that “cautions courts to assume that legislators take account of the legitimate sovereign interests of other nations when they write American laws.” Thus, American law should not be read to supplant the laws of Canada, Japan and other sovereign states when they are better able to protect their domestic customers from anticompetitive conduct. When the plaintiffs countered that there could be no conflict of law because all governments agreed that naked price fixing was bad, the Court was unpersuaded. “[S]everal foreign nations have filed briefs here arguing that to apply our remedies would unjustifiably permit their citizens to bypass their own less generous remedial schemes, thereby upsetting a balance of competing considerations that their own domestic antitrust laws embody.”

Plaintiffs enlisted a gaggle of economists to argue that allowing only domestic victims to file suit against an international cartel with a worldwide market would result in under-deterrence. Defendants did not address this argument directly, instead stressing that the deterrence mix is multifaceted and includes American private treble damages suits, American criminal prosecutions, and foreign enforcement actions. The defendants and

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16 Empagran, 542 U.S. at 64 (emphasis added).

17 Empagran, 542 U.S. at 164-65. The majority’s second argument was based on its understanding of the legislative history of the FTAIA. See Empagran, 542 U.S. at 162-63.

18 Empagran, 542 U.S. at 165. Amicus Briefs were filed on behalf of the defendants by seven foreign governments including Germany, Belgium, Canada, Japan, the United Kingdom, Ireland and the Netherlands.

19 Empagran, 542 U.S. at 167. These nations’ remedies varied widely, with American treble damages plus attorney fees falling near the top of the remedial scale.


21 Alternatively, if under-deterrence were indeed a concern, Congress could address this without permitting foreign claims by boosting penalties in the two domestic categories.
several amici argued, somewhat counter-intuitively, that increasing potential liability by permitting foreign plaintiffs to sue could actually reduce deterrence. Because an important element of the Department of Justice’s antitrust detection strategy is amnesty, a cartel member could see a reduction or elimination of its public penalty in return for cooperating with law enforcement officials. The benefits of cooperation, however, are reduced as exposure to private damages increases. Broadening civil exposure to include foreign plaintiffs, the defendants argued, would undermine the amnesty program and weaken deterrence. The Court acknowledged the disagreement, but declined to choose sides.

Not surprisingly, nations disagree as to the appropriate level of deterrence for anticompetitive activities. For international cartels, however, the policies of one nation will affect the policies of other affected nations. No country can determine the level of deterrence unilaterally. As the Court observed:

No one denies that America’s antitrust laws, when applied to foreign conduct, can interfere with a foreign nation’s ability independently to regulate its own commercial affairs. But our courts have long held that application of our antitrust laws to foreign anticompetitive conduct is nonetheless reasonable, and hence consistent with principles of prescriptive comity, insofar as they reflect a legislative effort to redress domestic antitrust injury that foreign anticompetitive conduct has caused.

However, the Court concluded, it would not be “reasonable to apply those laws to foreign conduct insofar as that conduct causes independent foreign harm and that foreign harm

\[\text{\footnotesize 22 See Brief for the United States as Amicus Curiae Supporting Petitioners; See also CITE [foreign countries].}\]

\[\text{\footnotesize 23 At oral argument, R. Hewitt Pate, Asst. Att’y Gen., as amicus curae in support of petitioners testified, “[g]iven the key role of deterrence, both in the opinion below and in the respondents’ arguments here, the United States thinks it important to offer the Court an accurate understanding of how international cartel enforcement really works. It’s only in the past 8 years that we’ve begun to see dramatic success in detecting and punishing international cartels, and that has come about only by international cooperation with other enforcement agencies and through the use of amnesty programs.” Transcript of oral Argument at 17, Empagran, 542 U.S. 155 (No. 03-724).}\]

\[\text{\footnotesize 24 “[R]espondents point to policy considerations, namely, that application of the Sherman Act in present circumstances will (through increased deterrence) help protect Americans against foreign-caused anticompetitive injury. Petitioners, however, have made important experience-backed arguments (based upon amnesty-seeking incentives) to the contrary. We cannot say whether, on balance, respondents’ side of this empirically based argument or the enforcement agencies’ side is correct.” Empagran, 542 U.S. at 174. Congress recently enacted legislation limiting the damage remedy to single damages for those granted amnesty. Antitrust Criminal Penalty Enhancement and Reform Act, Pub. L. No. 108-237, 118 Stat. 665 (2004). The European Commission has also recommended limiting damages for firms applying for leniency. Commission of the European Communities, White Paper on Damages for Breach of the EC Antitrust Rules, (2008).}\]

\[\text{\footnotesize 25 Empagran, 542 U.S. at 165.}\]
alone gives rise to the plaintiff’s claim.” When the adverse foreign effect is “independent of any adverse domestic effect,” the FTAIA would bar the plaintiffs. Although the Court in Empagran determined that the foreign effect of Vitamins, Inc. was independent of its domestic effect, removing the plaintiffs’ claim from FTAIA’s limited exception (and thus from the Sherman Act as well), a ray of hope remained. On appeal before the D.C. Circuit, the plaintiffs had presented two theories of their case, only one of which was addressed by the Court of Appeals. For this reason, the Supreme Court remanded so that the plaintiffs could present their alternative theory:

Respondents contend that, because vitamins are fungible and readily transportable, without an adverse domestic effect (i.e., higher prices in the United States), the sellers could not have maintained their international price-fixing arrangement and respondents would not have suffered their foreign injury. They add that this “but for” condition is sufficient to bring the price-fixing conduct within the scope of the FTAIA’s exception.

Instead of simply stating that for the cartel to succeed, prices would have to be fixed in both the foreign and domestic markets, plaintiffs argued that high domestic prices caused foreign prices to be high, thereby causing antitrust injury. On remand, the Court of Appeals rejected this argument, concluding that “but for” causation was insufficient. The domestic injury needed to be a proximate cause of the foreign plaintiffs’ injury. “The statutory language—‘gives rise to’—indicates a direct causal relationship, that is, proximate causation, and is not satisfied by the mere but-for ‘nexus’.”

The strained causality argument was a response to the Supreme Court’s rejection of the notion that the interrelation of the foreign and domestic markets would be enough for the plaintiffs to prevail. The “but for” versus “proximate” cause characterization doesn’t really help. As Judge Noonan observed in a concurring opinion post-Empagran, “[w]e . . . point not from guidance in words like ‘proximate’ or ‘direct’ but from a strong sense that the protection of consumers in another country is normally the business of that country. Location, not logic, keeps [Plaintiff’s] claim out of court.”

The simple economic point is that for the Vitamins, Inc. conspirators to maintain a cartel

26 Empagran, 542 U.S. at 165 (emphasis in original).
27 Empagran, 542 U.S. at 164.
28 “In light of our disposition in favor of appellant on other grounds, we find it unnecessary to address this ‘alternative’ theory of subject matter jurisdiction.” Empagran, 315 F.3d at 341.
29 Empagran, 542 U.S. at 175.
30 Empagran, 417 F.3d at 1271.
31 Plaintiffs felt precluded from making a more natural causation argument: high foreign prices caused, or at least enabled, domestic prices to be high.
32 In re Dynamic Random Access Memory (DRAM) Antitrust Litigation, 538 F.3d 1007, 1116-17 (9th Cir. 2008).
price anywhere, they had to maintain it everywhere. Domestic price-fixing, without more, would not cause foreign injuries; likewise, foreign price-fixing, without more, would not cause domestic injuries. The Empagran plaintiffs sought to argue the domestic price-fixing had a substantial effect on domestic competition (true), gave rise to an antitrust claim (also true) and therefore the foreign plaintiffs could sue. On remand, the Court of Appeals found that the causation was indirect. “It was the foreign effects of price-fixing outside of the United States that directly caused, or ‘gave rise to,’ their losses when they purchased vitamins abroad at super-competitive prices.” Therefore, the court concluded, the plaintiffs “[did] not establish . . . that the U.S. effects of the appellants’ conduct—i.e., increased prices in the United States—proximately caused the foreign appellants’ injuries.”

II. What’s Illinois Brick Got To Do With It?

Under federal law, if cartel member X sells to Y who then resells to Z, the direct purchaser (Y) can sue under the Sherman Act, but the indirect purchaser (Z) cannot. So decided the Supreme Court in Hanover Shoe and Illinois Brick. The direct purchaser can sue for the entire overcharge, regardless of whether it “passed on” any or all of it (Hanover Shoe) and the indirect purchaser cannot sue (Illinois Brick). A majority of states have adopted Illinois Brick repealers that permit suits by indirect purchasers. At the federal level, there has been some movement to overrule Illinois Brick. Given the inherent difficulty of determining the incidence of an overcharge, the federal bar against indirect purchasers’ suits is appropriate. In any event, the Illinois Brick rule was in place when Empagran was decided and remains the law.

During oral argument in Empagran, Justice Scalia raised Illinois Brick. In his questioning of respondent’s counsel he suggested the test proposed here:

I would think your defense against that is . . . not to assert that there's no effect on . . . foreign commerce, on our exports, because . . . I think there is. . . . I would think your defense is . . . in Section 2 of the Foreign Trade Antitrust Improvements Act, which requires that this effect on commerce,

33 Empagran, 417 F.3d at 1271.

34 Empagran, 417 F.3d at 1271.


37 “At the present, more than thirty-five states permit indirect, as well as direct, purchasers to sue for damages under state law” Antitrust Modernization Commission, Report And Recommendations 266 (2007).

on export commerce, gives rise to a claim under the provisions of Sections 1 to 7, and . . . the only way it gives rise to a claim on the part of these people is a claim as second purchasers, and Illinois Brick would have excluded their claim, I assume, if they are re-buying . . . from people in the United States. Wouldn't that be the case?39

He raised *Illinois Brick* again when questioning one of the plaintiff’s variations on the arbitrage/one market theme. Plaintiff argued that if there had not been price fixing in the United States, the foreign buyers would have purchased from the Americans at a lower price:

[I]t seems extraordinary to me that if . . . a foreign company had been injured by buying drugs from an American company that bought them from the conspirators at an excessively high price, that foreign company would not have a cause of action. But you’re saying that a foreign company has a cause of action by reason of the fact that had the American company not purchased at the artificially high conspiratorial price, but at a lower price, they might have purchased . . . from that intermediate person, . . . whereas *Illinois Brick* would clearly bar the first suit, you’re saying it doesn’t bar the second suit as a rationale for allowing them to sue here, and that strikes me as very strange.40

Neither the Supreme Court nor the Court of Appeals on remand followed up on Justice Scalia’s argument. *Illinois Brick* is mentioned in neither decision. Nonetheless, I believe that it is the key to finding at least one class of cases that would fall within the exception. To be clear, it is not that *Illinois Brick* provides the rationale; rather its role as a bar to certain domestic claimants is what matters. The FTAIA exception fills a void left by *Illinois Brick* when the direct purchaser is a foreign entity.

Suppose that we change the X-Y-Z hypothetical by adding a geographic component. A foreign conspirator X sells vitamins to distributor Y who then sells those same vitamins to domestic customer Z. As before, *Illinois Brick* would preclude a suit by the indirect purchaser (Z). But what about Y, the direct purchaser? If Y were a domestic firm, *Illinois Brick* would clearly allow the suit. But what if Y were a foreign firm? There are three possibilities: (1) bar the foreign suit so that X is liable to neither Y nor Z; (2) maintain the foreign bar while carving an exception to *Illinois Brick* that allows Z to sue whenever the direct purchaser is barred from doing so (in general or specifically when the direct purchaser is a foreign entity), or (3) keep *Illinois Brick* intact and allow Y to sue. The last option is a natural reading of the FTAIA exception: the effect on domestic commerce (Z) is direct and reasonably foreseeable (more on “substantial” below) and the effect itself (an elevated domestic price) gives rise to a Sherman Act claim.

Suppose we add another step to the X-Y-Z hypothetical. Instead of selling vitamins directly to U.S. customers, the direct purchaser (Y) adds the vitamins to pig feed and ulti-


40 Oral Argument at 35.
mately exports the pork to the United States. Suppose further that the price of vitamins is an insignificant contributor to the cost of American pork and that the exported quantity is too small to influence the American pork market. Thus, the impact of the overcharged vitamins would be confined to the economic rents of foreign producers. Could Y sue to recover the overcharge? It seems clear that this claim would falter before both clauses of the FTAIA exception. The conspiratorial overcharging might have a direct effect on some markets, but the effect on domestic markets would remain insubstantial (Clause 1). Since domestic pork prices would not be affected, the overcharge would not give rise to a Sherman Act claim (Clause 2). There are intermediate cases. Suppose instead that Y repackaged the vitamins and that the value added was ten percent. That could possibly pass the substantiality test. Where precisely the line should be drawn is something that courts would have to work out.

The FTAIA’s concern with “substantial” effects modifies the Illinois Brick rule when the direct purchaser is a foreign firm. If the direct purchaser were a domestic firm, the ultimate effect on final users would be irrelevant. Under Hanover Shoe, even if there were no impact on final users, a domestic direct purchaser could recover the entire overcharge (trebled). If the direct purchaser were foreign, however, liability would turn on the likelihood that the overcharge would be passed on to domestic customers as well as its magnitude.

One might argue that only the portion of the overcharge passed on to domestic customers should be included in a damages award, but this would recreate the very obstacles Illinois Brick allowed us to avoid. I propose a new interpretation of the FTAIA exception that incorporates a concern for international comity while eliminating the inherent difficulty of determining the incidence of an overcharge. This approach entails a two-step process in which liability is determined before damages are calculated. The “passing on” question arises only at the first stage, determining liability: Was it likely that there would be a discernible effect on the domestic market (substantiality)? Only if the claim passed this hurdle would a court proceed to the damages stage. Here, the foreign direct purchaser, like its domestic counterpart, would recover the full overcharge, but limited to the overcharge on goods actually sold into the United States. If the foreign direct purchaser resold 20 percent of its purchased vitamins to the United States, it could recover the overcharge on those goods. The overcharge on the remaining 80 percent would not provide the basis for recovery since the effect on domestic commerce by the sale of those goods would be indirect and therefore barred.

This narrow exception is consistent with the FTAIA and the Supreme Court’s interest in international comity. Foreign entities can sue only if the effect on the domestic price was direct and substantial—that is, only if a significant portion of the price increase was passed on to the domestic customers. For the most part, the interests of the foreign countries in maintaining their own remedy structures would be honored. Liability would be limited to the case in which the foreign sale resulted directly in a higher price to the eventual domestic customer.

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41 One of the Empagran plaintiffs was the Winddridge Pig Farm of Australia. Oral Argument at 7.
To illustrate the inquiry and limited nature of the exception I propose, consider *Den Norsk*, one of the two opinions causing the pre-*Empagran* circuit split. The Supreme Court’s decision in *Empagran* ratified the rejection of *Den Norsk*’s claim, though for reasons unrelated to the approach suggested here. *Den Norsk*, a Norwegian oil firm, sued providers of heavy-lift barge services who had conspired to suppress and eliminate competition by rigging bids and allocating customers and territories. There were only six or seven such barges in the world, so there was clearly a global market. As in *Empagran*, the court recognized that the price paid by the foreign plaintiff was inflated, but that fact alone did not give rise to liability.

The plaintiffs argued that the barges were an input in their production of offshore oil and that they sold a considerable amount of oil to the United States (roughly 400,000 barrels per day). The conspiracy, they claimed, “compelled Americans to pay supra-competitive prices for oil.” Under the approach suggested here, the first stage of the inquiry asks whether the overcharge for Norwegian barge services substantially impacted U.S. oil prices. If so, the second stage would determine damages based on the overcharge for barge services, not for the amount passed on to American consumers by inflated domestic oil prices. Further, the overcharge would be assessed not for all the barge services, but only for that fraction equal to the portion of the oil sold by the plaintiff into the United States. In *Den Norsk*, the numerator would be 400,000 barrels per day (the decision does not provide information on the denominator).

Would *Den Norsk*’s claim survive the first step? Almost certainly not. Norwegian oil production forms but a sliver of the international oil market. Any increase in the cost of producing Norwegian oil is unlikely to have a substantial impact on international oil prices generally and, therefore, U.S. domestic prices in particular. The effect would fall almost entirely on Norwegian economic rents. A court should hold that the claim fails to clear the first hurdle.

Under the suggested approach, *Den Norsk*’s claim would be dismissed from a U.S. court for want of a substantial effect on domestic commerce or trade. If, on the other hand, the effect were substantial, damages would be proportional to *Den Norsk*’s sales into the United States. In either case, *Den Norsk* would have recourse against the conspiratorial barge companies in Norwegian (or other foreign) courts for the impact on non-U.S. markets.

**III. Concluding Remarks**

There are a number of markets like the vitamin market in which domestic and international markets are tightly linked by arbitrage. An international cartel could not successfully fix prices in the domestic market without also fixing prices in the foreign market as well. And vice versa. That is the simple truth that formed the basis of the plaintiffs’

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42 *Den Norske Stats Oljeselskap As v. HeereMac Vof*, 241 F.3d 420 (5th Cir. 2001).

43 *Den Norske*, 241 F.3d at 426.
claims in *Empagran*. In their interpretation of the FTAIA the Supreme Court and the D.C. Court of Appeals acknowledged that truth, but concluded that it did not bring the plaintiffs within the FTAIA exception.

Building on arguments raised by Justice Scalia at oral argument, I have offered a simple—and very narrow—interpretation of the FTAIA exception. It fills the gap created by *Illinois Brick* when the direct purchaser is a foreign entity and domestic indirect purchasers face elevated prices. Domestic effects do not “bring about” foreign injury, as plaintiffs argue. Rather, domestic effects arise only if a substantial portion of the overcharge to foreign firms is passed on to their domestic customers. It should be clear that the foreign defendant’s exposure would be much less under this interpretation compared to the potential liability under the one market/arbitrage theories proposed by the *Empagran* plaintiffs. Practically, with this interpretation most foreign claims against foreigners would be barred.

The FTAIA, under this interpretation, provides some possibility of relief while respecting a concern for international comity. It would limit the foreign direct purchaser’s claims to those that have a substantial effect on the domestic market—that is, where a substantial portion of the overcharge is passed on to the domestic market. If the foreign purchaser bore most or the entire overcharge, its claim properly would fall within the scope of foreign governments’ competition policy, not that of the United States. If, on the other hand, the foreign purchaser resold a substantial portion of the overpriced goods into the domestic marketplace, causing a direct effect on domestic trade, the purchaser ought to have recourse in an American court.