Hughes Hubbard & Reed LLP
www.hugheshubbard.com INNOVATION STANDS OUT

ANTITRUST ADVISORY

SEPTEMBER 2002

U.S. Law Implications of International Cartel Enforcement Activity

The dramatic increase in worldwide antitrust enforcement activity against international cartels has generated waves of civil litigation, in both federal and state courts. These cases are notable for a number of reasons. They are typically class actions seeking damages in the hundreds of millions of dollars (or more) and are led by high-end plaintiffs' counsel. In addition, they are presenting ambitious theories of liability that bring to U.S. courts plaintiffs and claims having little, if anything, to do with U.S. commerce. Finally, since the subjects of the cartels are often industrial commodity products used worldwide, major domestic and multinational companies are purchasers of the commodities in question and find themselves in the unusual position of members of the plaintiff class.

The growth of governmental enforcement activity directed against price fixing has been dramatic. In the U.S., for example, the Department of Justice reported earlier this year that there were 35 sitting grand juries investigating suspected international cartel activities. In the last five years, the U.S. Government has collected about $2 billion in fines involving cartel activity. Six defendants have now been fined in excess of $100 million each. And, in a development that is of special significance to the international companies that typically are the subject of enforcement efforts, agreements involving U.S. jail time for foreign nationals have become commonplace.

The reasons for this increase in activity are complex. In the U.S., it is fair to say that the desire to enhance the competitiveness of worldwide markets is a strong motivating factor. Equally appealing, however, is the conclusion that generating $2 billion in fines in five years has been a wise use of resources (and not a bad addition to the resumes of career prosecutors). But much of the antitrust enforcement has not come from governmental initiatives. Corporate amnesty and leniency programs have brought unprecedented numbers of companies to approach the Justice Department on their own initiative, eager to confess their sins as well as the sins of their competitors in exchange for some relief from the financial risks of criminal prosecution. Interestingly, a driving force behind the growth of international anti-cartel enforcement has been the introduction of U.S.-style amnesty and leniency programs into the EU. Previously, a great impediment to use of the U.S. program was the fact that no comparable protection could be obtained under European law – a company's confession to U.S. authorities, in other words, significantly increased exposure in Europe. The availability of relief on a roughly parallel basis in the U.S. and the EU has reduced the disincentives significantly for many companies (especially European companies) having substantial sales across the Atlantic. Especially since

amnesty programs require disclosure of other cartel activity, U.S. prosecutors have had an easy time pursuing an expanding list of price fixing claims.

The corporate amnesty and leniency programs do not, of course, eliminate potential civil liability in the U.S.[1] And under the new regime, as under the old, the scope of criminal activity that is admitted very directly affects the course of subsequent civil litigation. The familiar reason is the inability of a party that has pled guilty to price fixing to deny that fact when later sued for damages. Companies considering entering into a plea agreement are wise to seek to minimize the scope of their exposure. This can take the form of limiting the period, products or customers admitted to be within the scope of a conspiracy. Most of these factors go to the volume of commerce affected by an admission and, thus, derivatively to potential civil liability. But the question of identifying customers who were victims of the price fixing scheme may also affect jurisdiction and the desirability or even the ability of civil litigation to be brought as a class action. By and large, it appears that DOJ will be reasonably accommodating in defining the scope of the victim class so long as it extracts the fine it is looking for.[2]

With so much money and the position as lead counsel at stake, it is not surprising that civil class action litigation is typically initiated well in advance of announcement of an indictment or consent order. The precipitating event can be disclosures of investigations in the press or even regulatory filings by manufacturers reporting that accounting reserves had been taken against potential liability. Where foreign companies are on the defendant side, a range of U.S. subsidiaries and foreign corporate entities are typically named as parties, raising difficult issues of jurisdiction that are often critical to the resolution of disputes about the availability of discovery. Plaintiffs may include both foreign and domestic companies, with claims involving transactions whose geographic locus may be well offshore.

From the standpoint of antitrust law, the most significant aspect of civil litigation over cartels has been the exploration of the extraterritorial applicability of the private damages remedy under the Sherman and Clayton Acts. The extent to which U.S. courts have subject matter jurisdiction over antitrust claims arising out of foreign activities or foreign injuries, or brought by foreign plaintiffs, is governed by judicial decisions involving the extraterritorial reach of the Sherman and Clayton Acts and, except as to "import trade," a 1998 amendment to the Sherman Act called the Foreign Trade Antitrust Improvement Act, or "FTAIA." Cases interpreting extraterritorial applicability are notoriously inconsistent. It is clear that an

[1] Civil liability for price fixing, as opposed to Government-imposed fines, has not traditionally existed in Europe, although that principle is under pressure from proposed changes to EU and national laws. While judicial decisions regarding the viability of various private claims are scarce, there is a growing record of such claims having been pursued in the courts and settled. Antitrust violations also have not generally been criminal worldwide, although a few countries, including Canada, Ireland, Japan, France, and Switzerland, impose criminal penalties on companies and/or individuals. New legislation has begun to reverse this view. *See, e.g.,* Enterprise Bill, Bill 115, introduced in the U.K. Parliament on March 26, 2002.

[2] One device that DOJ has used to minimize the scope of a plea is the "upward adjustment" of the fine that otherwise would be produced by application of Schedule R of the United States Sentencing Guidelines. The guidelines allow for the imposition of higher fines where various factors are present, and the concept has been used flexibly by agreement between the Government and defendants.

international conspiracy based on "foreign conduct" that is not intended to and does not have a "substantial effect" on U.S. commerce is not within the scope of the antitrust laws. *Hartford Fire Ins. Co. v. California*, 509 U.S. 764, 796 (1993). (The FTAIA precludes jurisdiction for export or foreign commerce where there is no "direct, substantial, and reasonably foreseeable" effect on U.S. commerce.) But defining "U.S. commerce" and "foreign conduct" has proved to be elusive in the context of international businesses in which planning, sourcing, and production are conducted with little regard for international boundaries. Areas of unsettled law abound. It has been a benchmark of antitrust law, for example, that the location of the injury, not of the plaintiff, controls for purposes of determining whether U.S. law applies. *See, e.g., Pfizer, Inc. v. Government of India*, 434 U.S. 308 (1978); *United States v. Aluminum Co. of America*, 148 F.2d 416 (2d Cir. 1945). In a number of recent decisions, however, the applicability of U.S. law has turned on whether the plaintiff is a U.S. entity or under the control of one. *See, e.g., Empagran S.A. v. F. Hoffman-La Roche, Ltd.*, Civ. No. 00-1686 (TFH), 2001 U.S. Dist. LEXIS 20910 (D.D.C. June 7, 2001); *In re Vitamins Antitrust Litigation*, Misc. No. 99-197 (TFH), 2001 U.S. Dist LEXIS 8903 (D.D.C. June 7, 2001). Other decisions have applied different jurisdictional tests depending on some characterization of the locus of actions and effects involved in a violation as either foreign or domestic. *Dee-K Enterprises v. Heveafil Sdn. Bhd.,* No. 01-1894, 2002 U.S. App. LEXIS 15256 (4th Cir. July 30, 2002); *Carpet Group Int'l v. Oriental Rug Importers Ass'n,* 227 F.3d 62 (3d Cir. 2000). Moreover, while the Supreme Court has held that an effect on domestic interstate commerce might be presumed from price fixing, it appears to be the case that, where foreign conduct is involved, injury in fact is a jurisdictional prerequisite. *Compare Summit Health, Ltd. v. Pinhas*, 500 U.S. 322 (1991), and *McLain v. Real Estate Bd. of New Orleans*, 444 U.S. 232 (1980), *with Hartford Fire, supra*.

One interpretive issue with potentially great implications is whether jurisdiction under the Sherman Act applies to a claim having no relation to U.S. commerce so long as the conspiracy giving rise to it did have such a geographic nexus. Earlier this year, the Second Circuit answered this question affirmatively, holding that the FTAIA did not preclude jurisdiction over claims of injury stemming from the payment of inflated buyer and seller premiums at foreign auctions where the conspiracy between the auctioneers (Sotheby's and Christie's) was intended to and did affect U.S. auctions as well. *Kruman v. Christie's Int'l plc*, 284 F. 3d 384 (2d Cir. 2002). The *Kruman* court did not reach the question whether the claimants had standing to sue, and there is substantial authority denying standing to individuals who were not injured in U.S. commerce. *See, e.g., In re Vitamins Antitrust Litigation, supra; Galavan Supplements, Ltd. v. Archer Daniels Midland Co.,* No. C 97-3259 FMS, 1997 U.S. Dist. LEXIS 18585 (N.D. Cal. Nov. 19, 1997). Similarly, there is some authority limiting antitrust venue in cases of foreign defendants to districts in which they reside, may be found, or transact business. *GTE New Media Services, Inc. v. Bellsouth Corp*., 199 F.3d 1343 (D.C. Cir. 2000). These decisions notwithstanding, a dissent by Judge Higginbotham in *Den Norske Stats Oljeselskap AS v. Heeremac VOF*, 241 F.3d 420 (5th Cir. 2001), would find that foreign claimants satisfied both the standing and venue requirements even where they were not injured in U.S. commerce. The somewhat breathtaking result is that it is now conceivable that where an international cartel affecting U.S. commerce exists, every injured party wherever it is located and wherever the injury occurred might have recourse to U.S. courts and the treble damages remedy.

Another potentially critical jurisdictional issue is whether a "substantial effect" on U.S. commerce, or something substantially less, must be shown for there to be jurisdiction, a debate

played out most notably in *Dee-K Enterprises, Inc.* and *Carpet Group Int'l.* The unsatisfactory genesis of litigation over this issue is the existence of these two dramatically different tests for jurisdiction set forth in Supreme Court cases in which the Court offered little guidance as to what facts or allegations caused the analyses to be different. Even the most diligent courts have been left to construct an appropriate test from very little more than an inference as to what the Supreme Court must have been thinking. It is difficult to believe that a test that requires a court to determine a single nationality for the "participants, acts, targets, and effects" of an alleged violation – the test enunciated in July of this year by the Fourth Circuit in *Dee-K Enterprises, Inc.* -- will be the final word on the subject.

As noted earlier, the recent wave of civil litigation over international cartel activity has been notable in that major U.S. corporations, typically the victims of abusive class action litigation, are finding themselves members of the plaintiff class. They have a number of interesting options. More often than not the defendants, large companies in their own right, continue to be suppliers of the plaintiffs. Good business reasons exist to resolve the pending issues within the context of an otherwise healthy and productive business relationship. Corporate claimants may also conclude that they do not wish to support large-scale class action litigation or pay the plaintiffs' class action bar for unnecessary services. These forces combine to suggest that the private resolution of claims between the defendants and the plaintiffs may be a sensible solution. Such settlements are not taxed by the deduction of a cut for the plaintiffs' lawyers, and enough private settlements may even undermine the viability of class claims.

One important limitation on federal antitrust claims is that only plaintiffs who purchased directly from the cartel members ordinarily may recover damages. *E.g., Illinois Brick Co. v. Illinois*, 431 U.S. 720 (1977). Although most courts construing state statutes that parallel § 4 of the Clayton Act have adopted *Illinois Brick* as a matter of state law, other state courts have rejected *Illinois Brick* and allowed "indirect" purchasers to seek damages. Legislatures in still other states, including such commercially important states as California (1978)[3] and New York (1998), have expressly authorized "indirect" purchasers to claim damages. These and other states also may allow the state government to bring *parens patriae* suits on behalf of "indirect" as well as "direct" purchasers. *E.g.*, California (1977); Illinois (1985) (exclusive remedy for "indirect-purchaser" claims). Whether created judicially or legislatively, these departures from *Illinois Brick* are not preempted by federal law. *California v. ARC America Corp.*, 490 U.S. 93 (1989). When criminal fines and trebled damages for "direct" claims and "indirect" claims at various levels of a distribution chain (without deduction for "passed on" overcharges) are added together, the total can be many times the defendants' extra revenues from fixing prices or allocating markets.

At least at the consumer level, individual "indirect-purchaser" claims are likely to be modest. Absent special statutory authorization (*e.g.,* D.C. Code Ann. § 28-4508(c) (1996)), virtually all state courts have refused to certify "indirect-purchaser" classes on the ground that common issues would not predominate. *But see generally B.W.I. Custom Kitchen v. Owens-*

---

[3] California reportedly has the fifth largest economy in the world.

Illinois, Inc., 1 Cal. Rptr. 2d 438 (Cal. Ct. App. 1987) (certifying a class of businesses that purchased indirectly from price fixing defendants).

Moreover, wholly apart from state antitrust statutes patterned after the Sherman and Clayton Acts, many states have enacted consumer protection statutes that may reach conduct that seems anti-competitive even though it might not rise to the level of a clear antitrust violation. *See, e.g.,* Cal. Bus. & Prof. Code §§ 17200 *et seq.* (covers "unlawful, unfair or fraudulent" business practices, including "incipient" antitrust violations and conduct that violates the "policy or spirit" of the antitrust laws or "otherwise significantly threatens or harms competition"). *E.g., Cel-Tech Communications, Inc. v. Los Angeles Cellular Tel. Co.,* 973 P.2d 527 (Cal. 1999).

* * *

The likelihood of a given company finding itself a defendant or a plaintiff in civil enforcement action arising out of international cartel activity is unquantifiable. In-house counsel can, however, probably learn a lot about the relevance of these issues through a review of the major products and markets in which the company does business. On the plaintiff side, experienced businesspeople may already have opinions as to markets that do not appear to have behaved competitively. On the defendant side, where far greater sums likely are at stake, potential problems may be more difficult to identify.

Two programs may help: first, the regular conduct of independent antitrust audits remains the best means to identify problems at an early stage, especially where efforts have been made to conceal the facts. Truly independent audits may also be the best available means to protect senior management from claims that they were complicit in unlawful activities. Second, a well-designed and diligently administered antitrust compliance program can assist in reducing the likelihood that improper steps will be taken, and in increasing the likelihood that questionable activities will be reported to in-house legal staff. While most companies have compliance programs in place, even the best should be reviewed in light of the increased impact of foreign activities in the U.S., the increased level of anti-cartel enforcement in Europe and the U.S., and the growth of amnesty programs.

This advisory was prepared by William T. Bisset. It is for informational purposes only and is not intended as legal advice. For more information on this subject or Hughes Hubbard's Antitrust Practice, please contact any of the following attorneys:

Washington, D.C.
John M. Townsend *202-721-4646* *townsend@hugheshubbard.com*

Los Angeles
William T. Bisset *213-613-2881* *bisset@hugheshubbard.com*

New York
James B. Kobak, Jr. *212-837-6757* *kobak@hugheshubbard.com*
Michael Salzman 212-837-6833 *salzman@hugheshubbard.com*