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Federal Court Allows Price Fixing Case to Proceed Against Chinese Manufacturers of Vitamin C

This week, a federal district court in New York allowed a putative antitrust class action against a group of Chinese vitamin C manufacturers to move forward, rejecting the defendants' argument on summary judgment that they were compelled by the Chinese government to export vitamin C at a minimum price.[1] The decision takes a narrow view of the doctrine of foreign sovereign compulsion – which may, in some circumstances, serve as a defense to antitrust liability – and suggests that even business conduct that is regulated by a foreign government may be subject to antitrust scrutiny in the United States.

In a 72-page opinion, Judge Brian Cogan of the United States District Court for the Eastern District of New York concluded that the defendant manufacturers were not entitled to summary judgment on grounds of foreign sovereign compulsion, even though the Chinese government had approved and even encouraged them to act as a cartel. Defendants, who together controlled around 80% of the worldwide market for vitamin C, did not dispute that they had entered into agreements to fix prices and restrict output of their products. Nevertheless, defendants argued that their conduct was shielded from liability because the Chinese government had compelled them to act as they did.

Notably, China's Ministry of Commerce – which has described itself as the highest administrative authority in China authorized to regulate foreign trade, including export commerce – had filed an amicus brief in support of defendants' earlier motion to dismiss the complaint, and also filed a statement supporting defendants' motion for summary judgment. The Ministry's brief marked the first time the Chinese government has ever appeared before a United States court as an amicus to present its views. The Court, however, declined to defer to the Chinese government's own interpretations of Chinese law. Instead, the Court relied on its own interpretations of Chinese law, and its assessment of the facts presented on summary judgment, to reach the conclusion that defendants' actions were voluntary and not the result of government compulsion.

The District Court acknowledged that the defense of foreign sovereign compulsion, together with the related doctrines of comity and act of state, serve to protect a foreign national from being "placed between the rock of its own local law and the hard place of U.S. law."[2] But that concern did not "protect defendants from their acknowledged violation of the antitrust laws," the Court stated, "because, here, there is no rock and no hard place."[3]

[1] *In re Vitamin C Antitrust Litigation*, No. 06-MD-1738 (E.D.N.Y. Sept. 6, 2011).

[2] *Id.*, slip op. at 2.

[3] *Id.*

Background

Although the relevant time period for this case begins in December 2001, the backdrop to the conduct at issue dates to the mid-1980s, when the Chinese government established various Chambers of Commerce for Import and Export. The Chambers of Commerce functioned both as government regulatory bodies, supervising import and export commerce, and as private trade associations, organizing trade shows and conducting market research. These included the Chamber of Commerce of Medicines and Health Products Importers and Exporters (the "Chamber"), of which defendants were members.

In 1996, China's Ministry of Commerce issued a report addressing perceived problems in the Chinese vitamin C industry. These included "a glut of capacity" as well as "'disorderly' and fierce export competition that resulted in companies 'blindly cutting prices.'"[4] The next year, the Ministry promulgated regulations for the vitamin C industry that required export licenses and set export quotas for individual companies and for the industry as a whole. The Ministry directed the Chamber to supervise the implementation of these regulations, including by establishing mandatory minimum export prices and coordinating prices industry-wide. Companies that violated the 1997 regulations, by "'competing at low price and reducing price through any disguised means,'" could have their export licenses suspended or even revoked.[5]

In early 2002, however, the 1997 regulations were abolished and were replaced with a new export regime. Under the new regime, known as "Price Verification and Chop," a variety of export products – including vitamin C – would no longer be subject to direct supervision and review by Chinese customs authorities, as they had been in the past. Instead, the Chambers were required to submit to customs "'information on industry-wide negotiated prices,'" and to affix a "chop," or seal, to export contracts confirming that they were made in accordance with industry agreements.[6] Export contracts that did not have a "chop" would not be accepted by customs.

Though Verification and Chop procedures applied to exports by members and non-members of the Chamber alike, after 2002, companies were no longer required to be members of the Chamber to export vitamin C. The 2002 regulations described the subcommittee of vitamin C manufacturers within the Chamber as "'a self-disciplinary industry organization jointly established on a voluntary basis by those [Chamber] members which conduct import and export of vitamin C.'"[7] Unlike the 1997 regulations, the 2002 regulations did not provide for revocation of a company's export license as a penalty for violating the Chamber's rules, although they did provide for other penalties – including public criticism and termination of membership in the Chamber.

Starting in late 2001, defendants met with each other and, through the Chamber, agreed on a "'coordinated export price'" for vitamin C. They also agreed to limit the total export volume of vitamin C to a specified amount. On its website, the Chamber described these meetings as

[4] *Id.* at 6.

[5] *Id.* at 7.

[6] *Id.* at 9.

[7] *Id.* at 11.

successful efforts by Chinese vitamin C manufacturers "to reach a self-regulated agreement . . ., whereby they would voluntarily control the quantity and pace of exports to achieve the goal of stabilization while raising export prices."[8] Over the following three years, defendants held several more meetings to coordinate prices and output under the auspices of the Chamber.

The Chinese Government's Statements to the Court

In 2005, plaintiffs filed their initial complaint, alleging that defendants had conspired to fix prices of vitamin C exports in violation of the U.S. antitrust laws. Defendants moved to dismiss, asserting the foreign sovereign compulsion defense, the act of state doctrine and the doctrine of international comity. The Chinese Ministry of Commerce filed an amicus brief in support of defendants' motion.

In its brief, and in an additional statement filed in support of defendants' motion for summary judgment, the Ministry took the position that the Chinese government had compelled defendants' actions. Among other things, the Ministry stated that the system of "self-discipline" referenced in the 2002 agreements "has a long history in China" and "does not mean complete voluntariness or self-conduct."[9] Rather, it refers to "a system of regulation under the supervision of a designated agency acting on behalf of the Chinese government."[10] In this case, that agency was the Chamber. "Persons engaged in such required self-discipline," the Ministry explained, "are well aware that they are subject to penalties . . . for non-compliance . . ., including forfeiting their export right."[11] Defendants' Chinese law expert echoed this understanding.

The Court's Analysis

Although rarely applied, the Court acknowledged that a defense of foreign sovereign compulsion may be available where a defendant's compliance with a foreign sovereign's laws would result in a violation of U.S. law. Along with a few federal courts, the U.S. Department of Justice and Federal Trade Commission have recognized this defense, explaining that it serves the principles of comity among nations as well as fundamental fairness.[12] The antitrust agencies have emphasized, however, that the defense is "limited" and applies only where (1) "a refusal to comply with the foreign government's command would give rise to the imposition of penal or other severe sanctions," and (2) the foreign government has given an order compelling anticompetitive conduct while acting in its governmental capacity.[13]

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[8] *Id.* at 19-20.

[9] *Id.* at 16.

[10] *Id.*

[11] *Id.*

[12] *See* U.S. Dep't of Justice & Fed. Trade Comm'n, *Antitrust Enforcement Guidelines for International Operations* § 3.32 (April 1995), *available at* http://www.justice.gov/atr/public/guidelines/internat.htm.

[13] *Id.*

Closely related to the foreign sovereign compulsion defense is the doctrine of international comity, which the Supreme Court has held may warrant abstention where there is "in fact a true conflict between domestic and foreign law."[14] A true conflict does not exist, the Supreme Court held, when a defendant can comply with both U.S. law and foreign law. Also related is the act of state doctrine, which holds that U.S. courts should refrain from deciding cases in which the outcome turns upon the legality or illegality of an official action performed by a foreign sovereign within its own territory.

Here, defendants maintained that their conduct was compelled by the Chinese government, that there was a conflict between U.S. antitrust law and Chinese export regulations, and that defendants' actions were acts of state because they had been directed by the Ministry. The Court rejected all of these arguments and concluded that defendants were not compelled by the Chinese government to fix prices and restrict output of vitamin C; rather they engaged in that conduct voluntarily. The Court identified three main bases for its conclusion.

First, the Court found that the relevant law and regulations on their face did not suggest compulsion and that Ministry's interpretation of Chinese law did not warrant deference. The Ministry's position, the Court found, was not supported by documentary evidence and was – at least to some degree – contradicted by prior statements of the Chinese government. For example, China had previously represented to the World Trade Organization that it had given up "export administration . . . of vitamin C" as of January 1, 2002, whereas the Ministry suggested that the government continued to regulate exports of vitamin C years later. The Court criticized the Ministry's statement in support of the motion for summary judgment as "read[ing] like a carefully crafted and phrased litigation position," rather than "a frank and straightforward explanation of Chinese law," and dismissed the Ministry's assertion of compulsion as "a post-hac attempt to shield defendants' conduct from antitrust scrutiny."[15]

Second, the Court found that there were no significant penalties for non-compliance with the Chamber's "self-disciplinary" regime. The threat of loss of membership in the Chamber was not a significant penalty because, under the 2002 regulations, membership was no longer required to export vitamin C. Moreover, the Court made much of the fact that at least one manufacturer had openly violated the defendants' agreement to restrict output and had not been penalized for doing so.

Third, the Court found that to the extent that the Chinese government compelled any action by defendants, it was limited to setting minimum prices and output levels at a point that would have avoided anti-dumping liability and below-cost pricing. Defendants were not required to set prices at any particular level above cost or to impose any further restrictions on output. By doing so, defendants "exceeded the scope of any compulsion" and their actions, therefore, "would not be immunized by the [foreign sovereign compulsion] defense."[16]

Throughout its analysis, the Court emphasized that the conduct that defendants argued had been compelled by the government was fully consistent with their own economic self-

[14] *Hartford Fire Ins. Co.* v. *California*, 509 U.S. 764, 798 (1993) (internal quotation marks omitted).

[15] *In re Vitamin C*, slip op. at 46-47.

[16] *Id.* at 60.

interests. Though it is not an element of the defense that the conduct at issue run contrary to the defendant's self-interest, the Court observed that it could not "ignore the obvious fact that a compulsory regime is unlikely to be present where the defendants' economic interest is in accordance with the allegedly compelled conduct."[17]

Conclusion

The Court's decision in *In re Vitamin C Antitrust Litigation* has potentially broad repercussions for foreign corporations that export products to the United States, and especially for Chinese manufacturers in a variety of industries operating under similar regulatory systems to those at issue here. As the Court noted at the outset of its opinion, two similar price-fixing actions are currently pending in other districts against Chinese manufacturers of magnesite and bauxite.[18]

In one of those pending cases, *Animal Science*, the district court preliminarily reached an opposite conclusion from the *Vitamin C* court, on similar facts. There, the court took judicial notice of, and afforded deference to, the Ministry's amicus brief and summary judgment statement in the *Vitamin C* case. In contrast to the *Vitamin C* court, which found that no deference to the Ministry's interpretation of Chinese law was warranted, the *Animal Science* court observed that "a foreign sovereign's admission of legal compulsion of its subjects might warrant a high – often nearly binding – degree of deference, even if the admitted compulsion was based on what might be deemed, in American jurisprudence, a form of 'unwritten law.'"[19]

The *Animal Science* court also held that the fact that defendants took part in enacting the price restrictions at issue, under the auspices of one of the Chambers, was of limited or no relevance to whether defendants were compelled by the government to obey those restrictions once they had been enacted. The *Vitamin C* court expressly disagreed, observing that "[i]f the defendants in *Animal Science* were not compelled to reach minimum price agreements in the first instance, the fact that such agreements were enforced would not appear sufficient to establish the [foreign sovereign compulsion] defense."[20]

Ultimately, the *Animal Science* court declined to reach a conclusive determination on whether the compulsion defense applied, because it held that plaintiffs had not established the court's subject matter jurisdiction over the dispute. Last month, the Third Circuit Court of Appeals vacated the district court's decision with respect to the jurisdictional issues, and remanded the case for the court to address plaintiffs' claims on their merits. On remand, the district court may be required to revisit the issue of sovereign compulsion, which the appellate court did not address, and to grapple with the intervening opinion in the *Vitamin C* case.

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[17] *Id.* at 47.

[18] *See Animal Science Prods., Inc.* v. *China Nat'l Metals & Minerals Import & Export Corp.*, 702 F. Supp. 2d 320 (D.N.J. 2010), *vacated and remanded on other grounds*, ---F.3d----, 2011 WL 3606995 (3d Cir. Aug. 17, 2011); *Resco Prods., Inc.* v. *Bosai Minerals Group Co. Ltd.*, No. 06-235, 2010 WL 2331069 (W.D. Pa. June 4, 2010).

[19] *Animal Science*, 702 F. Supp. 2d at 426.

[20] *In re Vitamin C*, slip op. at 36.

As these cases work their way through various federal district courts and courts of appeals, the contours of the foreign sovereign compulsion doctrine will be further refined. In the meantime, the *Vitamin C* opinion suggests that application of the doctrine may be narrowly limited and that even business conduct that is approved or encouraged by a foreign government may be found to violate the antitrust laws of the United States. The decision also underscores that foreign corporations should exercise caution with respect to participation in trade organizations involving competitors – even those that bear a government imprimatur – and should seek advice on the U.S. antitrust law implications of such organizations' activities.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

Moses Silverman
212-373-3355
msilverman@paulweiss.com

Aidan Synnott
212-373-3213
asynnott@paulweiss.com

William B. Michael contributed to this client memorandum.

NEW YORK
1285 Avenue of the Americas
New York, NY 10019-6064
+1-212-373-3000

BEIJING
Unit 3601, Fortune Plaza Office
Tower A
No. 7 Dong Sanhuan Zhonglu
Chao Yang District, Beijing 100020
People's Republic of China
+86-10-5828-6300

HONG KONG
12th Fl., Hong Kong Club Building
3A Chater Road
Central Hong Kong
+852-2846-0300

LONDON
Alder Castle, 10 Noble Street
London EC2V 7JU
United Kingdom
+44-20-7367-1600

TOKYO
Fukoku Seimei Building, 2nd Floor
2-2, Uchisaiwaicho 2-chome
Chiyoda-ku, Tokyo 100-0011
Japan
+81-3-3597-8101

TORONTO
Toronto Dominion Centre
77 King Street West, Suite 3100
P.O. Box 226
Toronto, ON M5K 1J3
Canada
+416-504-0520

WASHINGTON, D.C.
2001 K Street NW
Washington, DC 20006-1047
+1-202-223-7300

WILMINGTON
500 Delaware Avenue, Suite 200
Post Office Box 32
Wilmington, DE 19899-0032
+1-302-655-4410