CPI's North America Column Presents:

China, Export Cartels and Vitamin C: American Second?

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Introduction

The Supreme Court will soon decide an unusual price-fixing case: *In re Vitamin C Antitrust Litigation.*[2] It is unusual because the defendants – Chinese manufacturers – do not deny they fixed prices; because China claims it ordered them to do so, but this is a controversial fact; because the jury rendered a verdict for the plaintiffs (direct US buyers) but the appellate court dismissed on comity grounds; and because the Supreme Court certified only a narrow question: Must a court treat as conclusive a nation's statement to the court interpreting its own law?

The case raises a series of fascinating issues apart from the certified question. In this essay, I do not engage directly with the certified question; but if my narrative has traction, it provides a powerful policy reason for the Supreme Court to hold that the trial court properly considered all of the evidence, not just China's word.

The Case

Chinese manufacturers fixed the prices at which they would export vitamin C to the United States. When sued by US direct purchasers, they said: foreign sovereign compulsion; the government made us do it. The Chinese government, by MOFCOM,[3] exceptionally appeared in the US court and said: yes, we compelled the price fixing. We ordered the firms to coordinate ("industry self-discipline" facilitated by the trade association)[4] "to forestall potential market disorders that might have limited the development of a healthy vitamin C export industry during China's transition from a command economy to a market-driven economy."[5] China wished to avoid anti-dumping sanctions and to avoid "what the government feared could be destructive export competition before the foundation for a healthy industry could be laid ...."[6]

The case went to the jury, which returned a verdict for the buyers. The Court of Appeals for the Second Circuit reversed the judgment entered on the verdict and remanded the case with instructions to dismiss, stating that China's word on compulsion should have been conclusive on the court; thus, China compelled the price fixing. The Chinese manufacturers, said the

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[2] In re Vitamin C Antitrust Litigation (Animal Science Products Inc. v. Hebei Welcome Pharmaceutical Co.), 810 F. Supp.2d 522 (E.D.N.Y. 2011)(denying defendants' motion for summary judgment); 837 F.3d 175 (2d Cir. 2016)(reversing judgment on jury verdict for plaintiffs), cert. granted, 138 S. Ct. 734 (mem. 2018).

[3] Ministry of Commerce of the People's Republic of China.

[4] The Chinese trade associations, or Chambers of Commerce, are not entirely private like US trade associations. They have, or at least have had, a deep government presence.

Under the self-discipline system for export price fixing of Vitamin C, the manufacturers would (and MOFCOM says must) decide on the export price. When they wished to export they would submit their export plans to the Chamber. The Chamber would verify that the price was at or above the agreed price, and if so the Chamber would affix a seal called a "chop." Customs was charged with reviewing the contracts and at least notionally permitting export only if the contract bore a chop. This system was put into place by the 2002 PVC (price verification and chop) Notice.

[5] Brief for Amicus Curiae Ministry of Commerce for the People's Republic of China (06-MD-1738), text following note 12, Pet. App. 207a.

[6] Id., Pet. App. 207a-208a.

court, therefore faced a true conflict (follow US law: don't fix prices in the United States, or China's law: fix prices in the United States); and China's interest in protecting its firms from US law so clearly outbalanced America's interest in enforcing its law that the district court abused its discretion as a matter of law in deciding not to abstain on comity grounds. The question certified by the Supreme Court is whether China's word on compulsion was in fact conclusive on the trial court or whether the trial court properly took other evidence into account.

What is the answer to this technical question? Is a foreign sovereign's statement to the court interpreting its own law conclusive on the court? An answer to this abstract question requires a deep contextual response, and that is a purpose of this essay.

My essay proceeds as follows. First, resetting the stage. Second, distinguishing this case from extraterritoriality cases. Third, distinguishing private price fixing from state action. Fourth, examining the scope of the US foreign sovereign compulsion defense. Fifth, questioning whether *Vitamin C* is better understood as a case of characterization under US law rather than as centrally about interpreting foreign law. Sixth, asking, after foreign sovereign compulsion analysis, is there any work left for comity?

Resetting the Stage

When reading the opinion of the Court of Appeals of the Second Circuit, one can lose sight of the facts that this is a case of a naked cartel, and China's whole role in the picture is to free its manufacturers from the consequences of violating the clear and notorious rule of US law forbidding price fixing. The US rule is in line with virtually every one of the 130 antitrust nations of the world including China.[7] It is understood that price fixers have to pay for their offense.

Can a country step forward and say to its exporting price fixers: "Not to worry. I can immunize you. I just have to say the word."

If the answer is no, the question of who interprets foreign law is irrelevant. If the answer is sometimes, and even if China gets to say that its regulation and scheme amounted to an order to its firms to fix prices, then we should ask whether China's command and the manufacturers' behavior surrounding it amounted to foreign sovereign compulsion under US law.

Extraterritoriality

The Second Circuit opinion centrally invokes *Timberlane*[8] and *Mannington Mills,*[9] presenting the problem in *Vitamin C* as one of extraterritoriality requiring a comity balancing as an initial screen. But *Vitamin C* is quintessentially territorial in today's shared understanding of the

[7] The law in place in China at the time of the price-fixing was the 1997 Price Law. "That law technical outlaws, inter alia, price fixing … and seeking exorbitant profits." Harris, Wang, Zhang, Cohen and Evrard, Anti-Monopoly Law and Practice in China 12 (2011).

[8] Timberlane Lumber Co. v. Bank of America, 549 F2d 597 (9th Cir. 1976).

[9] Mannington Mills, Inc. v. Congoleum Corp., 595 F.2d 1287 (3d Cir. 1979).

reach of a nation's law. It does not raise territorial issues. The only, and the only intended, effects were in the United States, not in China (except as the home of extra profits). The offense in *Vitamin C* is the converse of the offense in *Mannington Mills,* which was fraudulent procurement of foreign patents blocking Mannington Mills from foreign markets. It has no resemblance to *Timberlane*, in which plaintiff lost a chance to buy a Honduran lumber mill because of a conspiracy in Honduras between Honduran rivals and a bank. The territorial grounding in *Vitamin C* is the reverse of *Empagran*,[10] where buyers in South America and Australia sued cartelists from Europe and Asia in the US under US law. In short, in *Vitamin C*, the Sherman Act clearly applies.

Can private price fixing ever be immunized by foreign state action?

Is private price fixing in or into a country that forbids it ever a proper subject on which a foreign sovereign can grant immunity to its own firms?

I shall turn to the content of the foreign sovereign compulsion defense in the next section. It is narrow. It does not reach a command *to conspire in the United State*s to fix prices in the United States.[11] I will argue that there is no practical difference whether the price fixers meet in China or in the US; the place of the effect is what matters. In this section, I concentrate on the "ownership" of the conduct that is the offense.

The United States has a domestic state action defense.[12] Under US law, action of a state of the United States can shield private conduct from the federal antitrust laws when certain conditions are met. But one category of conduct is out of bounds and cannot be shielded: A state may not order private price fixing and declare the conduct immune from the federal antitrust laws.[13] Why? Because the fixed price is still a privately fixed price, and firms have the incentive to maximize their profits at the expense of consumers. The privately-set price does not qualify as state action. A "gauzy cloak" of the state will not do.[14]

China goes one big step farther than the United States under its new Anti-Monopoly Law (adopted after the conduct in *Vitamin C*). Not only is state action not a cover for price fixing in China. It is a violation of China's Anti-Monopoly Law for any organ of government in China to compel price fixing. Such an order would constitute an abuse of administrative monopoly.[15]

The law of the European Union has a compatible doctrine. European law governs whether and when Member States can justify their anticompetitive acts that affect the Community. When Italy set the price of matches and ordered the Italian match producers to collectively parcel out quotas among the manufacturers, and the Italian producers gave very low quotas

[10] F. Hoffmann-LaRoche Ltd. v. Empagram S.A., 542 U.S. 155 (2004).

[11] US DOJ and FTC 2017 Antitrust Guidelines for International Enforcement and Cooperation, §4.2.2.

[12] California Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc., 445 U.S. 97 (1980).

[13] Id.; Schwegmann Bros. v. Calvert Distillers Corp., 341 U.S. 384 (1951).

[14] Cantor v. Detroit Edison Co., 428 U.S. 579 (1976); Midcal, *supra* note 12.

[15] Agencies and government bodies in China "shall not abuse their administrative powers to compel undertakings to engage in monopolistic activities that are prohibited under this Law." Anti-monopoly Law of the People's Republic of China (promulgated by the Standing Comm. Nat'l People's Cong., Aug 30, 2007, effective Aug. 1, 2008), art. 36. Price-fixing is a monopolistic activity prohibited by Article 13 of China's Anti-monopoly Law.

to the Germans and Swedes and large ones to themselves, the Italian firms were liable for setting the quotas *in an anticompetitive way.* [16]

Two observations follow: 1) Private price fixing, even if ordered by the state, remains private price fixing. 2) Even compelling firms to fix prices does not compel them to do so most exploitatively, and there is no reason – in comity or fairness – to exempt the extra windfall profits; and there were such extra profits in *Vitamin C*.[17]

A third observation is called for. Allowing a *foreign* state to override the law of the target territory is even more dangerous than allowing a state within that territory to do so. In the latter case there are checks and balances: voting, commerce clause offenses, and federal legislative preemption. But in the case of a nation ordering its firms to price fix to the foreigners, the victims are at the will of the foreigners' power and have no recourse.

What does the foreign sovereign compulsion defense require?

The foreign sovereign compulsion defense has been litigated in only a handful of cases. The Supreme Court has never grappled with its scope and the lower court cases are of old vintage. Much has happened in the global economy in the past 40 years, and there is room and opportunity for shaping the doctrine to modern needs.

In any event, the contours of the foreign sovereign compulsion defense as understood by the US antitrust agencies are stated in the 2017 US Antitrust Agencies' Antitrust Guidelines for International Enforcement and Cooperation (sec. 4.2.2.).[18] The Guidelines state:

> "[When] persons find themselves subject to foreign legal requirements that conflict with the laws of the United States …, courts have recognized a limited defense against application of the U.S. antitrust laws when a foreign sovereign compels the very conduct that the U.S. antitrust laws would prohibit."

A foreign jurisdiction's approval or encouragement of the conduct does not bar application of the US law "even when the foreign jurisdiction has a strong policy in favor of the conduct in question."

The defense requires 1) a command of a foreign state; 2) "the foreign government's command would give rise to the imposition of penal or other severe sanctions"; and 3) "the compelled conduct can be accomplished entirely within the foreign sovereign's own territory."

Does China's conduct meet the foreign sovereign compulsion defense according to the Guidelines? There are several reasons why it may not (and perhaps for this reason the Second Circuit did not reach the issue; it decided the case solely on comity grounds). There was room

[16] Consorzio Industrie Fiammiferi (Italian matches), case C-198/01, EU:C:2003:430.

[17] The defendants sometimes charged more than the agreed price they reported to the government and on which the seal and verification were based.

[18] The Guidelines identify two rationales that underlie "the limited defense." First, under certain circumstances the defense "serves to accommodate equal sovereigns." Second, fairness requires "a predictable rule of decision."

for the jury to find that the manufacturers did not "find themselves" caught in a conflict; that they wanted to fix prices and may have sought their government's blessing; that they did not *have to* agree on prices with their rivals and indeed some did not; that even if they were part of the consortium that negotiated the agreed price, they could charge less with impunity; they were not compelled to agree to more than a competitive price, and they surely were not compelled to charge more than the "formally" agreed price. They, through the Chamber (the trade association), could suspend the regime requiring the Chamber to verify the export price and affix a seal to the export documents (verification and chop). The manufacturers, if at all sophisticated, must have known of the notorious US law and they took the risk.

Moreover, I would argue that the offending conduct could not be accomplished entirely in China. It was not over until the sales were made. Fixing prices in China for delivery to the United States is surely as severe in its effect and as unlinked to home country regulatory choices as is fixing prices in the United States for delivery to the United States. The only differences are that it is easier and more convenient for Chinese firms to conspire in China and the offense is less likely to be detected. The time has come to erase the rule that would make the place of conspiracy so consequential. Casting off this rule for purposes of a compulsion justification would correspond with casting it off for purposes of jurisdiction, as in the *Wood pulp* case,[19] wherein the Court of Justice of the European Union adopted a version of the effects doctrine: What matters is not where the conspirators met, but where the conspiracy was "implemented." The foreign sovereign compulsion defense should simply not be available to naked cartel conduct implemented and intended to be implemented in the United States.

Who says whether China's acts constitute foreign sovereign compulsion under US law?

There is a missing link in the arguments concerning whether the price fixing was compelled. The Court of Appeals opinion says: China told the court that the applicable regulation – the 2002 PVC Notice – which on its face and in its context appears to create a voluntary system, in fact created a mandatory system. China's word on interpretation of Chinese law is conclusive (the court held); therefore China compelled the price fixing.

But the district court took on board exactly how (as MOFCOM described), the price fixing came about. It specified the facts of the Chamber meetings and the notices and regulations, as well as the manufacturers' and officials' acts. Even if the Notice and export control conduct amounted to a command, there was a serious question whether the circumstances amounted to "compulsion" under the US law. Is the answer a matter of interpreting Chinese law or a matter of characterizing the facts to determine if the US doctrine of foreign sovereign compulsion applies? Characterization of China's behavior and the manufacturers' response under all of the circumstances would seem to be a question involving mixed questions of fact and law under the Sherman Act.

[19] A. Ahlstrom Osakeyhtio v. Commission (Wood pulp), cases C-89, 104, 114, 116-117, 125-129/85 EU:C:1988:447.

What work is left for comity?

The foreign sovereign compulsion defense is a focused application of comity. While the unavailability of the defense may or may not preclude dismissal on plenary comity grounds,[20] it surely sets the compass, with US enforcement as the default. Credible candidates for general comity dismissal may be rare. If Country A was experiencing a shortage of a critical medicine needed at home, and strongly requested its manufacturers to agree to allocate sales at home and limit exports, and the manufacturers did so, that would be a credible case for justification. It would, in turn, be a good case for expanding the foreign sovereign compulsion/action defense and turning the issue into one of law (interpretation of the defense) and not one of discretion. Indeed, the cases one can imagine as credible for deference would probably be dismissed in any event under *Empagran* as not covered by the Sherman Act in the first instance.

The above discussion suggests that the proper order of analysis regarding foreign sovereign compulsion and general comity should be foreign sovereign compulsion first and general comity second, with the latter as an unlikely but possible residual category. The Second Circuit took the opposite route.

If one reaches the general comity issue, the right questions are: Does the US antitrust law, in this application, unduly interfere with China's choices in regulating its own economy, outweighing the US interest in freeing its economy of price fixing and compensating the victims? Second, because the doctrine is based on reciprocity, would the courts of China probably grant a similar favor to the United States? Suppose, for example, that the United States emphatically urges or even compels Qualcomm and a competing intellectual property (IP) owner to fix their royalty rates on chips for handsets into the Chinese market; and that the US does so to preserve the integrity of American IP by assuring that its firms will realize the true value of their IP, and thus to preserve the firms' and the nation's competitiveness in the world. Would China reciprocally withhold antitrust enforcement against Qualcomm and its competitor?

An affirmative answer to the undue interference question would be strained. An affirmative answer to the reciprocity question would be naive.

Conclusion

In this globalized world, sovereigns must accommodate themselves to the legitimate interests of one another. *Vitamin C* is one of several cases guiding the search for appropriate norms of accommodation.

There are times when the United States must fit into China's system, as when China applies

[20] See US International Antitrust Guidelines, at Example E.

We know from *Hartford Fire Ins. Co.* (509 U.S. 764, 1993), that where foreign defendants' conduct has an effect in the United States and was intended to affect the United States and defendants face no direct conflict, dismissal for comity is not available. In the spirit of *Hartford*, taking account of the fact that the foreign sovereign compulsion defense is a tool for comity, it can be argued that in cases of a naked price-fixing cartel under the cloak of foreign state direction, where the conduct does not qualify for foreign sovereign compulsion, comity dismissal is not available.

its Anti-Monopoly Law to sales and licenses by Americans into China.[21] There are times when China must fit into the US system, as when the United States applies its antitrust law to sales by Chinese firms into the United States.[22] *Qualcomm (China)*[23] is a paradigmatic case for the first proposition. *Vitamin C* should be a paradigmatic case for the second. Unless the Second Circuit decision is reversed, China wins, both ways.

[21] This proposition is debated. US officials have expressed concern about the aggressive reach of China's law, for example, to limit royalty rates on Qualcomm's intellectual property. See Michael Martina and Matthew Miller, As Qualcomm decision looms, U.S. presses China on antitrust policy, Reuters (Dec. 15, 2014). Critics argue that the Chinese anti-monopoly law is innovation-chilling in its application to intellectual property and is actually Chinese industrial policy, not true antitrust. See International Competition Policy Expert Group, Report and Recommendations (United States Chamber of Commerce, March 2017), *available at* https://www.uschamber.com/sites/default/files/icpeg_recommendations_and_report.pdf.

[22] This proposition too is debated, as witnessed by the *Vitamin C* case. China asserts that the US should respect the industrial policy of China to help its firms ease into a market system.

[23] See Noel Randewich and Matthew Miller, Qualcomm to pay $975 million to resolve China antitrust dispute, Reuters (Feb. 9, 2015).