

CPI's Asia Column Presents:

*Animal Sci. Prods. v. Hebei Welcome
Pharm. Co.
(2d Cir. 2016)*

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On September 20, 2016, the United States Court of Appeals for the Second Circuit issued an opinion that may significantly impact Chinese companies doing business in the United States. The Second Circuit reversed and remanded a decision by the United States District Court for the Eastern District of New York denying a motion to dismiss and a motion for summary judgment brought by two Chinese defendants, Hebei Welcome Pharmaceutical and North China Pharmaceutical (collectively, “Hebei Welcome”). The motions were brought in response to a complaint filed by several U.S. vitamin C (“VC”) purchasers accusing Hebei Welcome and several Chinese VC manufacturers of violating Sherman and Clayton Acts by fixing VC prices. At the district court, the Chinese Ministry of Commerce (Hereinafter “the Ministry”) submitted an amicus brief, to explain relevant Chinese laws and policies in support of Hebei Welcome’s motions. On appeal, the Second Circuit held that the district court should have accorded deference to the Ministry’s interpretation of Chinese laws. The Second Circuit is one of the most influential federal appellate courts in the United States. This decision sets up an important precedent for Chinese manufacturers facing potential antitrust allegations in the United States.

Background:

In the 1990s, the Chinese government facilitated industry-wide consolidation and implemented policies in response to the reduction in VC prices in the global market. Policies implemented, including granting export quota license to Chinese VC manufactures, were aimed at reducing the amount of VC available for exportation to influence the prices in the global market. By 2001, when China joined WTO, China had captured 60% of the VC global market. As a WTO member state who vowed to become a more market-driven economy, China reformed its economic policy in various industries, including the VC industry, by loosening its governmental regulations. In the VC industry, China has changed the regulatory approach from an export quota regime to a “price verified chop” regime (“PVC”). PVC requires VC manufacturers and associations to negotiate a lowest industry-wide exporting price for VC. Such price would then be used to determine which company would be allowed to export. Only VC manufacturers submitting documents to the trade associations, documenting that their exporting prices are above the lowest industry price, will receive an official chop granting permission to export.

In 2005, multiple US VC purchasers, including Animal Science Products and The Ranis Company, accused several Chinese VC manufacturers of violating the U.S. antitrust laws. By fixing a lowest exporting price, the plaintiffs said, the defendants formed an industry-wide cartel which controlled VC price in the global market. This cartel, the plaintiffs said, functioned to create a shortage in the VC industry in order to maintain China’s leading exporter status, which harmed the plaintiffs’ interests. Many defendants settled with the plaintiffs soon after the case was brought. Only Hebei Welcome and its parent company, North China Pharmaceutical, went forward to defend their positions.

At the district court, the two defendants didn’t deny the plaintiffs’ allegations; instead, the defendants said that VC manufactures in China were required to export at or above the lowest exporting price under the PVC regime. The defendants moved to dismiss the case

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based on the principles of state act, sovereign immunity and international comity. In an historical act, the Ministry submitted an Amicus Curiae brief to support the defendants' position. In the brief, the Ministry explained that the Chinese laws mandated the PVC regime and that the alleged cartels were industry associations supervised by the Ministry.

Nevertheless, the district court did not give deference to the Ministry's statements. Instead, it denied the motion in order to allow for further discovery regarding whether the defendants' actions were truly compelled by relevant Chinese laws or regulations. The parties subsequently conducted discovery in response to the district court's decision. After the limited discovery, the defendants filed a motion for summary judgment based on the same three grounds.

The plaintiffs opposed both motions and argued their positions from the following three standpoints. First, the plaintiffs offered expert testimony to support their position that Chinese laws do not require VC manufacturers to fix a lowest exporting price. As such, the plaintiffs argued that Chinese laws were not in conflict with U.S. antitrust laws. Second, the plaintiffs argued that the defendants were part of the driving force that pushed the price-fixing laws into existence because the laws helped the defendants to maintain their competitive status in the global market. Third, the plaintiffs provided evidence showing that there were circumstances where the defendants did not comply with the requirements of the PVC regime and exported VC at prices lower than the industry mandated lowest price. The plaintiffs argued that these circumstances showed that the Chinese government did not actually enforce the laws.

The district court considered the evidence submitted by both parties. Although the court acknowledged the relationship between the industry associations and the Ministry, it determined that the Ministry's interpretation of the Chinese laws was undermined by the Ministry's failure to explain certain critical provisions of the PVC regime. The district court declined to adopt the Ministry's explanation of the PVC regime and the requirements of relevant Chinese laws. Instead, the court accepted the explanations provided by the plaintiffs' expert witness. The district court ultimately concluded that the Chinese laws did not require the defendants to fix VC prices and denied the defendants' motion for summary judgment.

The case went to trial. The jury returned a US\$147 million verdict against the defendants. The defendant appealed to the Second Circuit.

Appellate Process:

On appeal, the Second Circuit concluded that the district court failed to apply the principle of international comity in this case. The Second Circuit explained that:

Comity is both a principle guiding relations between foreign governments and a legal doctrine by which U.S. courts recognize an individual's acts under foreign law. Comity, in the legal sense, is neither a matter of absolute obligation, on the one hand, nor of mere courtesy and good will, upon the other. It is the recognition which one nation allows within its territory to the legislative, executive or judicial acts of another nation, having due regard both to international duty and convenience, and to the rights of its own citizens or of other persons who are under the protection of its laws. This doctrine is not just a vague political concern

favoring international cooperation when it is in our interest to do so but rather it is a principle under which judicial decisions reflect the systemic value of reciprocal tolerance and goodwill.

Based on the case law precedent, the appellate court applied the following ten-factor test to determine if the international comity principle should apply in this case:

(1) Degree of conflict with foreign law or policy; (2) Nationality of the parties, locations or principal places of business of corporations; (3) Relative importance of the alleged violation of conduct here as compared with conduct abroad; (4) The extent to which enforcement by either state can be expected to achieve compliance, the availability of a remedy abroad and the pendency of litigation there; (5) Existence of intent to harm or affect American commerce and its foreseeability; (6) Possible effect upon foreign relations if the court exercises jurisdiction and grants relief; (7) If relief is granted, whether a party will be placed in the position of being forced to perform an act illegal in either country or be under conflicting requirements by both countries; (8) Whether the court can make its order effective; (9) Whether an order for relief would be acceptable in this country if made by the foreign nation under similar circumstances; and (10) Whether a treaty with the affected nations has addressed the issue.

True Conflict Analysis

The focus of the dispute between the parties with respect to the applicability of international comity lays on the first element of the test, which was whether there was a true conflict between the relevant Chinese laws and the U.S. antitrust laws.

The Second Circuit determined that the district court's conflict analysis was incorrect and a true conflict existed in this case. First, based on case law, the Second Circuit pointed out that when a foreign government appeared in the litigation and submitted official statements interpreting the laws of their country, U.S. courts should give deference to that interpretation. Courts should neither challenge that interpretation nor make an independent analysis. Therefore, when the Ministry submitted an amicus brief that interpreted the PVC regime, and per such an interpretation, one could conclude that complying with the PVC regime would lead to a violation of the U.S. antitrust laws, a true conflict exists. Second, the Second Circuit stated that analyzing the motive of the Chinese government in making these laws, as the district court did, is barred by the principle of sovereign immunity. Whether the defendants would benefit from these laws would be irrelevant to the true conflict analysis. The Second Circuit similarly found that whether the Chinese government enforced these laws or whether the defendants complied with them would also be irrelevant to the true conflict analysis.

Other Elements under the International Comity Principle

The Second Circuit also considered other elements of the international comity principle. The court concluded that the conflict between China's export policies and the U.S. antitrust laws should be resolved through diplomatic channels or the WTO proceedings. Although it was reasonably foreseeable that China's economic policies could have negative impacts on VC purchasers in the international market, there was no direct evidence showing that these policies were aimed at the plaintiffs or other U.S. companies.

The Second Circuit further pointed out that the district court's judgment, if upheld, would require the defendants to comply with conflicting legal requirements. It would also be unlikely that the injunctive relief that the plaintiffs obtained from a U.S. court would be enforceable in China.

Furthermore, the Second Circuit observed that according to the Ministry, the district court's exercise of jurisdiction had already negatively affected U.S.-China relations. The court mentioned that the Chinese Government had repeatedly made known to the federal courts, as well as to the United States Department of State in an official diplomatic communication relating to this case, that it considered the lack of deference it received in our courts to be "disrespectful."

After considering all elements of the test for applying international comity, the Second Circuit determined that China's national interest in regulating its VC industry outweighed the United States' interest in exercising its antitrust laws. The Second Circuit held that because a true conflict existed between the Chinese laws and the U.S. antitrust laws and the alleged violations of U.S. antitrust laws were to fulfil the requirements of the Chinese laws, the district court should not have exercised jurisdiction over this case. The Second Circuit vacated the judgment entered by the district court, reversed the order that denied the defendants' motion to dismiss, and remanded to dismiss the plaintiffs' complaint.