September 22, 2016

Deferring to China's Interpretation of Its Own Regulation, Second Circuit Throws Out $147 Million Antitrust Judgment

On September 20, 2016, the Second Circuit reversed a $147 million antitrust judgment against two Chinese companies on international comity grounds in the long-running *In re Vitamin C Antitrust Litigation* in the Eastern District of New York. No. 13-4791-cv (2d Cir. Sept. 20, 2016). The central issue on appeal was whether Chinese law required the defendants to jointly set prices and quantities of vitamin C sold abroad, thereby raising an irreconcilable conflict with the U.S. Sherman Act's prohibition on horizontal price-fixing. In the key portion of its unanimous ruling, the Second Circuit panel of Judges Cabranes, Wesley, and Hall held that a federal court is bound to defer to an official statement submitted by a foreign government explaining its own laws and regulations, if it is reasonable under the circumstances presented. Op. at 30.

Background

The decision stems from a suit brought by U.S. purchasers of vitamin C alleging that the defendants—Chinese vitamin C manufacturer Hebei Welcome Pharmaceutical Co. and its holding company, North China Pharmaceutical Group Corporation—and their alleged co-conspirator formed a cartel to fix prices and restrict the supply of vitamin C to be exported to the United States and worldwide. Op. at 5-6. The defendants moved to dismiss the complaint on the basis that they were acting pursuant to Chinese regulations regarding vitamin C export pricing. Op. at 7. The central issue was the status of the defendants' alleged co-conspirator, the "China Chamber of Commerce of Medicines & Health Products Importers & Exporters" (the "Chamber"): The plaintiffs asserted that this entity was akin to a trade association in the U.S., while the defendants maintained that it was "a government-controlled 'Chamber' of producers, unique to China's state-controlled regulatory regime." Op. at 6-7 & n.4.

In what the Second Circuit characterized as "an historic act," the Ministry of Commerce of the People's Republic of China filed an *amicus curiae* brief with the district court in support of the defendants' motion to dismiss. Op. at 7. The Ministry explained that the Chamber was a "Ministry-supervised entity authorized by the Ministry to regulate vitamin C export prices and output levels." Op. at 8 (internal quotation omitted). The Ministry further provided submissions to the district court representing that "all of the vitamin C that was legally exported during the relevant time was required to be sold at industry-wide coordinated prices." Op. at 11. This was accomplished via a "price verification and chop" ("PVC") policy, whereby "vitamin C manufacturers were required to submit documentation to the Chamber indicating both the amount and price of vitamin C it intended to export," and the Chamber would approve the contract (by affixing a seal known as a "chop") "only if the price of the contract was at or above the

minimum acceptable price set by coordination through the Chamber." Op. at 11 (internal quotations omitted).

The district court denied defendants' motion to dismiss to allow for further discovery as to defendants' assertions that their actions were compelled by the Chinese government, and then denied defendants' subsequent motion for summary judgment raising the same issues. *See In re Vitamin C Antitrust Litig.*, 584 F. Supp. 2d 546 (E.D.N.Y. 2008) (denying motion to dismiss); *In re Vitamin C Antitrust Litig.*, 810 F. Supp. 2d 522 (E.D.N.Y. 2011) (denying motion for summary judgment). In its opinion denying summary judgment, the district court "decline[d] to defer to the Ministry's interpretation of Chinese law," on the basis that the Ministry had failed "to address critical provisions" of the PVC regime that, in the court's view, "undermine[d] its interpretation of Chinese law." 810 F. Supp. 2d at 551. The district court further cited Federal Rule of Civil Procedure 44.1[1] as granting the district court "substantial discretion to consider different types of evidence" beyond the Ministry's official statements. *Id.* at 561. The district court determined that the defendants' alleged anticompetitive conduct was not compelled by Chinese law, and following a trial, a jury found the defendants liable for violations of Section 1 of the Sherman Act, and the district court awarded the plaintiffs approximately $147 million in damages.

The Second Circuit's Opinion

The Second Circuit's analysis began with an in-depth review of the principles underlying international comity, a prudential doctrine permitting U.S. courts to abstain from exercising their jurisdiction over a case with extraterritorial dimensions, where hearing the case could create a conflict with the laws and policies of foreign nations. Op. at 15-17. The Second Circuit focused mainly on whether there was a "true conflict" between the Sherman Act's proscription on horizontal price-fixing and the Chinese PVC policy purportedly requiring defendants "to fix the price and quantity of vitamin C sold abroad." Op. at 22-23. This analysis, as the panel observed, "hinges on the amount of deference that we extend to the Chinese Government's explanation of its own laws." Op. at 23.

The Second Circuit's analysis on this point focused in particular on the Supreme Court's decision in *United States* v. *Pink*, 315 U.S. 203 (1942). In *Pink*, the Supreme Court held that "an official declaration of the Russian Government" regarding the extraterritorial reach of a 1918 decree nationalizing its insurance business was "'conclusive' as to the extraterritorial effect of the decree." Op. at 24 (quoting *Pink*, 315 U.S. at 220). The Second Circuit then referred to subsequent examples of U.S. courts citing *Pink* and according conclusive deference to the Mexican Attorney General's interpretation of a government decree expropriating oil rights, and an opinion from Philippines Department of Justice articulating the

1 Fed. R. Civ. P. 44.1 provides in relevant part that, "[i]n determining foreign law, the court may consider any relevant material or source, including testimony, whether or not submitted by a party or admissible under the Federal Rules of Evidence. The court's determination must be treated as a ruling on a question of law."

scope and effect of a law of the Philippines. Op. at 24-25 (citing *D'Angelo* v. *Petroleos Mexicanos*, 422 F. Supp. 1280, 1284 (D. Del. 1976), *aff'd*, 564 F.2d 89 (3d Cir. 1977) and *Delagado* v. *Shell Oil Co.*, 890 F. Supp. 1324, 1363 (S.D. Tex. 1995), *aff'd*, 231 F.3d 165 (5th Cir. 2000)).

The panel strongly rejected the district court's view that "the Second Circuit [has] adopted a softer view towards the submissions of foreign governments." *Vitamin C*, 584 F. Supp. 2d at 557. In particular, the Second Circuit rejected the district court's characterization of Federal Rule of Civil Procedure 44.1 as having modified the deference due to foreign governments, noting that the Rule "explicitly focuses on *what* a court may consider when determining foreign law, but it is silent as to *how* a court should analyze the relevant material or sources." Op. at 27 (emphasis in original).

The panel likewise distinguished two prior Second Circuit cases relied upon by the district court, *Villegas Duran* v. *Arribada Beaumont*, 534 F.3d 142 (2d Cir. 2008) and *Karaha Bodas Co.* v. *Perusahaan Pertambangan Minyak Dan Gas Bumi Negara*, 313 F.3d 70 (2d Cir. 2002). In *Villegas Duran*, the Second Circuit declined to credit an affidavit submitted by the Chilean Government clarifying the appellant's child custody rights under Chilean law. 534 F.3d at 148. The *Vitamin C* panel noted, however, that (1) in *Villegas Duran*, the Chilean Government—unlike the Chinese Government in the instant case—did not appear either as a party in interest or an *amicus*, and (2) the Supreme Court subsequently adopted the Chilean Government's interpretation of the law relying upon the very same affidavit in a later case. Op. at 28 (citing *Abbott* v. *Abbott*, 560 U.S. 1, 10-11 (2010)). In *Karaha Bodas*, the Second Circuit wrote that "a foreign sovereign's views regarding its own laws merit—although they do not command—some degree of deference," 313 F.3d at 92, but, as the *Vitamin C* court deemed relevant, the *Karaha Bodas* panel nevertheless adopted the Indonesian Government's interpretation of its own regulation in issue. Op. at 29-30. The *Vitamin C* court noted that, "[i]ndeed, we have yet to identify a case where a foreign sovereign appeared before a U.S. tribunal and the U.S. tribunal adopted a reading of that sovereign's laws contrary to that sovereign's interpretation of them." Op. at 30.

The Second Circuit then clarified the level of deference due to the Chinese Government's submissions, writing that

> Consistent with our holding in *Karaha Bodas* and the Supreme Court's pronouncements in *Pink*, we reaffirm the principle that when a foreign government, acting through counsel or otherwise, directly participates in U.S. court proceedings by providing a sworn evidentiary proffer regarding the construction and effect of its laws and regulations, which is reasonable under the circumstances presented, a U.S. court is bound to defer to those statements. If deference by any measure is to mean anything, it must mean that a U.S. court not embark on a challenge to a foreign government's official representation to the court regarding its laws or regulations, even if that representation is inconsistent with how those laws might be interpreted under the principles of our legal system.

Op. at 30 (internal citations omitted).

Applying this standard, the court noted that, although the PVC policy "does not specify how the 'industry-wide negotiated' price was set, we defer to the Ministry's reasonable interpretation that the term means what it suggests—that members of the regulated industry were required to negotiate and agree upon a price." Op. at 32-33. The court further reasoned that, although "the terms 'industry self-discipline,' 'coordination,' and 'voluntary restraint'" used in the PVC policy "may suggest that the Defendants were not required to agree to 'industry-wide negotiated' prices, we defer to the Ministry's reasonable explanation that these are terms of art within Chinese law connoting the government's expectation that private actors actively self-regulate to achieve the government's policy goals in order to minimize the need for the government to resort to stronger enforcement methods." Op. at 33. "In short, by directing vitamin C manufacturers to coordinate export prices and quantities and adopting those standards into the regulatory regime, the Chinese Government required Defendants to violate the Sherman Act." Op. at 33-34.

The Second Circuit concluded its analysis of the issue by "reiterat[ing] that deference in this case is particularly important," citing the complexity of the Chinese legal system and its stark differences with the American legal system. Op. at 34. The court cited "the ambiguity of China's laws as a reason to defer to the Ministry's reasonable interpretation," rather than a reason for the district court to conduct its own searching inquiry. Op. at 35. In particular, the Second Circuit considered "irrelevant" the district court's concerns that the defendants themselves had petitioned the Chinese Government to grant its imprimatur to their conduct: "Whether Defendants had a hand in the Chinese government's decision to mandate some level of price-fixing is irrelevant to whether Chinese law actually required Defendants to act in a way that violated U.S. antitrust laws." Op. at 36. Similarly, the panel rejected arguments, raised by plaintiffs, that the PVC policy was not actually enforced, saying "[w]e are disinclined to view this factual evidence of China's unwillingness or inability to enforce the PVC regime as relevant to PVC regime's legal mandate." Op. at 38.

The court completed the analysis by finding that the remaining applicable international comity considerations favored dismissal: (1) the defendants were Chinese nationals with their principal places of business in China; (2) the relevant conduct occurred in China; (3) complaints as to China's export policies could be adequately addressed through diplomatic channels or the World Trade Organization; (4) there was no evidence that the defendants acted with intent to affect U.S. commerce; (5) the exercise of jurisdiction had already had a negative impact on U.S.-China relations, with the district court's judgment prompting the Chinese Government to send a diplomatic communication to the U.S. State Department complaining of the "lack of deference it received in our courts"; and (6) the fact that if a Chinese court attempted to enjoin a U.S. company from complying with U.S. economic regulations, "we would undoubtedly decline to enforce that order." Op. at 41-43. The court vacated the $147 million judgment and ordered the complaint dismissed with prejudice. Op. at 45.

Significance

Vitamin C clarifies that, within the Second Circuit, a foreign government's official statement to a federal court interpreting that government's own laws and regulations is due conclusive deference in most circumstances. The Second Circuit's ruling underscores the significant value to litigants disputing a question of foreign law in being able to persuade a foreign governmental entity to appear and submit a favorable interpretation of its law to the court. Indeed, the Chinese Government's participation in *Vitamin C* was ultimately worth $147 million to the defendants.

Vitamin C, however, was not absolute in its embrace of foreign governments' interpretations of their own laws. The Second Circuit subtly placed two conditions on its general rule. *First*, the foreign government itself must appear in the actions, whether as a party in interest or as *amicus curiae*, for conclusive deference to obtain: indeed, the Second Circuit "note[d] that if the Chinese Government had not appeared in this litigation, the district court's careful and thorough treatment of the evidence before it in analyzing what Chinese law required at both the motion to dismiss and summary judgment stages would have been entirely appropriate." Op. at 35 n.10; *see also* op. at 28 (distinguishing *Villegas Duran*'s refusal to credit a Chilean Government affidavit interpreting its law "because the Chilean Government did not appear before the court in that case, either as a party or as an *amicus*").

Second, and perhaps more significantly, *Vitamin C* conditioned conclusive deference on the foreign government's explanation of its own laws being "reasonable under the circumstances presented[.]" Op. at 30. Although the court did not explore the contours of this qualification in detail, it did, in a footnote, note that "[t]o the extent there is no documentary evidence or reference of law proffered to support a foreign sovereign's interpretation of its own laws, deference may be inappropriate." Op. at 30 n.8. Furthermore, this qualification suggests that a federal court need not credulously accept a foreign government's explanation of its law if it otherwise seems suspect given the totality of the circumstances. It may be the case, for example, that a court may, consistent with *Vitamin C*, decline to credit a foreign government's explanation of its own law that is irreconcilable with that foreign government's previous statements regarding the same law.

Vitamin C is also notable for its detailed discussion of the differences between the Chinese and American legal systems. The court explicitly acknowledged that an American legal analytic framework is not well adapted to interpreting Chinese law, noting that "Chinese law is not as transparent as that of the United States or other constitutional or parliamentary governments," and that, "rather than codifying its statutes, the Chinese government frequently governs by regulations promulgated by various ministries[,] and private citizens or companies may be authorized under Chinese regulations to act in certain circumstances as government agents." Op. at 34 (quoting *Vitamin C*, 584 F. Supp. 2d at 559) (alterations in original omitted). The Second Circuit found that these differences counseled in favor of "[d]eferring to the [Chinese Government's] explanation of what is legally required under its system . . . where, as here, the

record evidence shows a clear disparity between China's economic regulatory regime and our own." Op. at 35.

* * *

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:

Robert A. Atkins
212-373-3183
ratkins@paulweiss.com

Craig A. Benson
202-223-7343
cbenson@paulweiss.com

Joseph J. Bial
202-223-7318
jbial@paulweiss.com

Andrew C. Finch
212-373-3460
afinch@paulweiss.com

Andrew J. Forman
202-223-7319
aforman@paulweiss.com

Kenneth A. Gallo
202-223-7356
kgallo@paulweiss.com

Jonathan S. Kanter
202-223-7317
jkanter@paulweiss.com

William B. Michael
212-373-3648
wmichael@paulweiss.com

Jacqueline P. Rubin
212-373-3056
jrubin@paulweiss.com

Charles F. (Rick) Rule
202-223-7320
rrule@paulweiss.com

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

Joseph J. Simons
202-223-7370
jsimons@paulweiss.com

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

Associate Michael J. Biondi contributed to this client alert.