

February 10, 2006

PAGE ONE
Planned Economy

As China's Trade Clout Grows, So Do Price-Fixing Accusations

**Manufacturers of Vitamin C
And Mineral Used in Steel
Are Cited in U.S. Civil Suits**

The Opposite of Dumping

By **JOHN R. WILKE** in Washington and **KATHY CHEN** in Beijing
 February 10, 2006; Page A1

Ten years ago, China's pharmaceutical firms had a sliver of the world's market for vitamin C. Today, China is the OPEC of vitamin C.

Chinese manufacturers currently supply more than 85% of the vitamin C used in the U.S. Just like the oil cartel, they can heavily influence world prices. After a 2001 agreement among China's four largest producers, spot prices for vitamin C rose to as high as \$9 a kilogram from lows of less than \$3.

Cooperation among competitors is illegal in the U.S. when it leads to higher prices for consumers. So far, about half a dozen civil antitrust suits have been filed against Chinese vitamin C manufacturers in various U.S. courts. Federal prosecutors in Texas are reviewing similar allegations, though the Justice Department hasn't yet decided whether or not to pursue criminal charges, people close to the inquiry say.

As China becomes ever more dominant in manufacturing, its ability to dictate the prices of industrial and consumer products is steadily rising. As a result, Chinese manufacturers are increasingly running afoul of Western antitrust law in products from vitamin C to a mineral used in steel production. These legal struggles could become another point of tension in the U.S.-China relationship, which has been tested by disagreements over matters from textile tariffs to the trade deficit.


Stormy Cs

Average wholesale price per kilogram of
vitamin C imports from China.

 \$7
 

Chinese companies deny breaking U.S. law and have hired U.S. law firms to mount a defense. The companies are expected to argue they are acting as agents of the Chinese government and therefore aren't subject to antitrust law. A Chinese industry

DOW JONES REPRINTS

 This copy is for your personal, non-commercial use only. To order presentation-ready copies for distribution to your colleagues, clients or customers, use the Order Reprints tool at the bottom of any article or visit: www.djreprints.com.

- [See a sample reprint in PDF format.](#)
- [Order a reprint of this article now.](#)

executive says the companies raised prices to stave off accusations they were "dumping," or illegally selling products abroad at below cost to win market share.

There are signs the vitamin C model is migrating to other Chinese exports. In a meeting of Chinese makers of the pain reliever acetaminophen, the companies "fervently indicated their wish to use the example of vitamin C industry self-regulation," according to minutes posted on the group's Web site. Prices subsequently jumped 20%. Chinese makers of saccharin, rayon and magnesite -- a mineral used in steel production -- recently formed similar alliances. Magnesite producers also are being sued in the U.S.

In the case of saccharin, Chinese producers had been accused by the U.S. Commerce Department of dumping. Then in March 2003, five companies formed a "Saccharin Subcommittee" of the China Chamber of Commerce, a quasigovernment body. They declared that low prices no longer made sense now that they had overtaken their U.S. and South Korean rivals.

"Due to disorderly internal competition...various enterprises lost huge profits" and had to pay antidumping duties levied by the U.S., according to minutes of the meeting posted on the group's Web site. The companies agreed to raise export prices and said "self-regulation should continue into 2004 to prevent the mutual slaughtering of aggressive competition."

William Isaacson, a Washington lawyer who filed the first of the civil lawsuits against Chinese producers of vitamin C and magnesite, says these aren't isolated instances. "Once Chinese companies can control a market, this becomes their business model," he contends. His vitamin C case is pending in federal court in Brooklyn, N.Y. The magnesite case was filed in U.S. District Court in Newark, N.J.

American courts have been increasingly willing to claim jurisdiction across international borders in antitrust cases if harm can be shown to U.S. consumers. U.S. companies that use vitamin C include makers of dietary supplements, soft drinks and animal feed.

Monopolies remain active in parts of China's economy, even though price-fixing was formally outlawed in 1998. A sweeping new antimonopoly law is being drafted in Beijing. Its adoption has been slowed by squabbling among Chinese government agencies forced to give up the ability to set prices. It isn't clear if the new law would bar price collusion in the vitamin market.

China's state-run pharmaceutical companies began making vitamin C in 1958 catering to domestic demand. In the late 1970s, Chinese government researchers found a way to speed up the basic production process, which is done by fermenting ascorbic acid. Chinese companies then could make vitamin C in two steps rather than five, as was common in the West.

Looking Abroad

Vitamin C, thus, was among the first Western drugs for which China developed its own intellectual property and a clear cost advantage over foreign rivals. With its new

technology, Chinese producers began to look for sales abroad. The promise of export profits attracted new producers. Production lines multiplied and volume soared.

Northeast Pharmaceutical Group Co. was one of the first to begin exporting. Based in the gritty industrial city of Shenyang, 800 miles northeast of Beijing, Northeast is among the biggest Chinese vitamin C producers and boasts that it is one of China's best-known pharmaceutical brands. It employs 8,000 workers making products from antibiotics to the AIDS drug AZT. Vitamin C is its best seller, with more than 15,000 tons a year under production.

China's vitamin makers got a big break in 1997, thanks to an earlier antitrust dispute. After a long investigation, the U.S. Justice Department accused European and Japanese companies of price-fixing in a dozen vitamins, including vitamin C. It became the largest-ever criminal antitrust case, resulting in nearly \$1 billion in government fines and several jail terms for executives.

With the European-Japanese cartel broken, Chinese companies flooded the market with low-price vitamin C, forcing plant closings and consolidation among European and Japanese firms. Chinese companies, who previously had been overshadowed by their bigger rivals, quickly captured much of the world market.

Prices fell sharply from the high of \$12 a kilo established by the European and Japanese cartel members in 1996. By late 2001, competition pushed prices down to \$2.80 a kilo. (A kilogram equals 2.2 pounds.)

People familiar with the matter say China's vitamin C makers were told at that time by the Chinese government to deal with Western complaints about price dumping. They say the companies took that to mean they should coordinate to raise prices.

Ma Xiaoye, director of independent think tank Shanghai Academy for World Watch and a former Chinese trade official, says the government routinely encourages Chinese companies to "coordinate" to avoid price wars that often spark antidumping charges, a practice he says is legal. He says these requests aren't binding and that the groups don't usually set specific prices.

Mr. Ma says these efforts often don't result in any agreement. "Vitamin C was an exception, because there are only a few companies," Mr. Ma says. "It was easier" for them to agree on an approach.

In November 2001, the four largest Chinese producers formed the Vitamin C Chapter of the China Chamber of Commerce of Medicines & Health Products Importers & Exporters. On its Chinese-language Web site, the chapter announced a "self-discipline agreement...to stabilize and raise export prices."

Soon after, spot prices for vitamin C shot up to as high as \$7 a kilo. By 2003, rising demand and supply shortages pushed the price higher.

Guan Ningyun, legal director of the China Chamber of Commerce of Medicines & Health

Products Importers & Exporters denies the group sets prices, saying in an interview that "it's the market force that pushes prices up."

The rise enticed a few Chinese producers to grab market share by cutting their prices, according to the U.S. civil suits. U.S. import data show a noticeable price dip in mid-2003.

In November, the Vitamin C trade group held an "emergency meeting" in which members again agreed not to cut prices, according to allegations in the U.S. civil suits. Spot prices rose to as high as \$9 a kilo by the end of December. As U.S. lawyers readied lawsuits at the end of 2004, prices again drifted downward. It also is possible that some Chinese producers were backsliding on their promises. In recent months, as antitrust scrutiny increased, U.S. prices have fallen to as low as \$3.80 a kilo.

Bulk purchasers of vitamin C in the U.S. were buffeted by the price swings. "We were paying about \$4 a kilo, then within a year it was \$8," says Bradley Reynolds, a vice president at Animal Science Products Inc., Nacogdoches, Texas, who says the higher costs hurt profits. The family-owned, feed-supplement company blends vitamins for customers from catfish farmers to pet-food makers.

Mr. Reynolds's family firm is a lead plaintiff in one of the civil lawsuits against the Chinese vitamin C makers. It was among the U.S. businesses that won damages in the European vitamin case. Though he won't divulge the amount, Mr. Reynolds says, "it wasn't near as much as they stole."

Livestock feed accounts for about 10% of U.S. vitamin C consumption. About a third goes to food and beverage makers, where it is used as a preservative as well as a nutrient. The rest is used in pharmaceuticals and diet supplements.

The proliferation of private antitrust suits against Chinese companies has brought teams of U.S. lawyers to China seeking to defend them. Attorneys looking to defend Chinese magnesite producers recently took part in a bake-off in Beijing. The first round included 30-minute pitches in an auditorium at the China Chamber of Commerce of Metals, Minerals & Chemicals. In later meetings, held in ornate ceremonial rooms over rounds of steaming chrysanthemum tea, lawyers made individual presentations about their defense strategy.

The Chinese executives rarely spoke, the U.S. participants say, but appeared to understand every word. Their Chinese lawyers quizzed the U.S. attorneys closely about U.S. law and cited the latest cases and law-review articles. A similar competition was held for law firms seeking to represent Chinese vitamin C manufacturers.

Some attorneys maintain that antitrust law still is largely an alien concept for Chinese companies. "China today is where Japan or [South] Korea were a decade ago -- they don't fully appreciate the seriousness of these lawsuits and possible criminal investigations," says Kirby Behre, a Washington, D.C., lawyer with Paul, Hastings Janofsky & Walker LLP, which has numerous clients in China.

James Serota, an attorney with Greenberg Traurig LLP in New York, who is representing

Northeast Pharmaceutical, declines to comment, citing the pending civil cases. Other vitamin C makers who have been sued decline to comment. In the past, many have said they have done nothing wrong. North China Pharmaceutical Group Ltd. called the suits "groundless" in reports carried by Xinhua, the official China news agency, in June. In Xinhua reports, Shijiazhuang Pharmaceutical Group Ltd. said the suits were "deliberately provocative."

One Possible Defense

A recent court filing by Northeast Pharmaceutical in a Massachusetts state court signals one possible defense. The filing says Northeast is "supervised and directed" by the Shenyang municipal government and should be treated by U.S. courts as an "agent or instrumentality" of the People's Republic of China.

Under international law, sovereign nations are immune from antitrust enforcement by another country. That is why lawsuits against the Organization of Petroleum Exporting Countries are routinely dismissed. Although they have a number of different shareholders, the vitamin C makers are overseen by state officials and a majority of their stock is still held by government groups, according to Northeast's court filing.

It isn't clear how close these ties remain. A high-level official in the local government office that oversees North China Pharmaceutical says the government no longer "interferes" in management. "We don't help set prices, that concept is 20 or 30 years old," says the official. "They do what it takes to earn money."

Plaintiffs' lawyers are expected to challenge the immunity defense on the grounds that it doesn't apply to companies indirectly owned by the state or state-owned companies that engage in purely commercial activity.

China's chambers of commerce could be major figures in the cases. Many of the price agreements were set up under their auspices. These days, the chambers awkwardly combine their old role in China's centrally planned economy, in which they set prices and market standards, with their new one as champion of the country's newly privatized businesses. In some ways, they symbolize the learning process the country is undergoing as it becomes a key player in global trade.

"China's chamber of commerce has two personalities," says Wang Ming, deputy dean of School of Public Policy & Management at Tsinghua University.

U.S. trial lawyers are examining other Chinese industries for evidence of price fixing. Two of the firms that filed cases against Chinese vitamin C makers -- Boies Schiller & Flexner LLP, and Cohen, Milstein Hausfeld & Toll PLLC -- earlier won settlements of \$1.2 billion for U.S. businesses overcharged by the European vitamin cartel. They included drug giant Abbott Laboratories and cereal maker General Mills Inc.

The team of prosecutors and FBI agents looking into Chinese vitamin C is the same one responsible for breaking up the European vitamin cartel. But criminal price-fixing cases are extraordinarily difficult to prove. Witnesses and evidence are often beyond the reach of

investigators. This case, in particular, would be fraught with political and economic complications.

"These civil suits are probably going to go forward," predicts Mr. Behre, the Paul, Hastings lawyer. "But whether or not the government decides to bring a criminal case becomes a political question."

Mr. Reynolds, the Texas feed-supplement maker, doesn't think it's all that complicated. "If China is going to be a world player, they've got to play by the rules."

--Jane Zhang in Washington and Zhou Yang in Beijing contributed to this article.

Write to Kathy Chen at kathy.chen@wsj.com¹

URL for this article:

<http://online.wsj.com/article/SB113954082130170389.html>

Hyperlinks in this Article:

(1) <mailto:kathy.chen@wsj.com>

Copyright 2006 Dow Jones & Company, Inc. All Rights Reserved

This copy is for your personal, non-commercial use only. Distribution and use of this material are governed by our [Subscriber Agreement](#) and by copyright law. For non-personal use or to order multiple copies, please contact Dow Jones Reprints at 1-800-843-0008 or visit www.djreprints.com.