The China Syndrome

Law360, New York (January 24, 2011, 12:15 PM ET) -- Rumor has it that the next generation iPad will ditch Apple’s 30-pin connector in favor of a USB port. According to several industry and news reports, the reason for the purported change is the European Union’s preference for universal over proprietary connector ports.

As with any speculation regarding Apple’s products, no one will know the truth until Apple introduces iPad 2. But the mere fact that we treat the rumor as both credible and noncontroversial shows how we now accept that the EU may adopt antitrust rules that change or influence manufacturing decisions of U.S. companies.

U.S. and EU antitrust rules tend to be similar enough that we accept any difference as a tolerable consequence of the economies of scale driving global companies to sell a single product across jurisdictions. But what if those differences were more significant? What would U.S. companies do if one of the world’s biggest economies adopted antitrust rules that put at risk critically important business strategies? We soon may have to answer these questions.

China adopted its new Anti-Monopoly Law (AML) in 2008. Regulators since then have applied the AML sporadically and not always in ways that are consistent with the interests and expectations of U.S. companies, as in the rejection by the Ministry of Commerce of Coca-Cola’s bid for China Huiyuan Juice Group. These are still early days in Chinese competition law, and, given that it took U.S. authorities at least 50 years to adopt a rational, consistent and coherent analytical methodology in applying the Sherman Act, we can expect a long, bumpy ride from here.

A material conflict between U.S. and Chinese antitrust law that threatens core business strategies could put multinational companies in a bind. China is no longer merely an attractive manufacturing location. Rapidly rising incomes have produced a burgeoning consumer class and created a lucrative market. China’s middle class is small as a percentage of its total population but, because the population is so large, the number of middle-class Chinese soon may exceed the number of middle-class Americans.

McKinsey & Company projects that by 2025, urban households in China will spend as much as or more than is spent today by all Japanese households combined, and that prediction is probably conservative. Sales to this growing consumer class are producing an increasing share of the growth many global companies are experiencing, and it is no longer economically feasible for global companies to forego the opportunity to sell in the Chinese market.

What is the likelihood of China adopting antitrust rules that imperil the business strategies of U.S. companies? It might be greater than we would like to admit. Although one of the welcome developments of the past 30 years has been to root antitrust law more firmly in economics, a nation’s antitrust law reflects its social and political reality. The U.S. is a developed country with a mature economy, and it is no coincidence that our antitrust law
matured with our economy.

Chinese authorities presiding over an economy that is still in an early stage are certain to face intense political pressure from millions of small and struggling businesses advocating for antitrust rules or rulings that may not enhance consumer welfare. More broadly, China may decide that certain aspects of U.S. and EU antitrust law are incompatible with the interests of a developing economy.

That wouldn’t be unprecedented, even in our own history. Protectionism was the norm for centuries and antitrust doctrine was focused more on protecting competitors than consumers. In pre-World War II America, before the industrialization we take for granted today, a monopolist’s refusal to deal with its competitor was frequently considered a violation of Section 2 of the Sherman Act.

Today, we know that refusals to deal can enhance consumer welfare by encouraging brand investment and systems-level competition. One would hope that China and other countries adopting new antitrust regimes leverage their advantage of learning from this experience, and, to its credit, China has spent much time and effort studying our antitrust law. But the risk is that Chinese regulators will reject a pro-competitive policy that enhances consumer welfare globally because they fear it will create negative, short-term domestic effects they deem unacceptable.

That China’s AML is in an embryonic stage only exacerbates this possibility. Before it can implement a coherent antitrust law, China must develop its courts and its regulatory agencies, acquire deeper and broader levels of expertise, and resolve power disputes between national and provincial authorities. All of this will take years and maybe even decades, and the AML is unlikely to be applied in a consistent way until China makes substantial progress in those areas. The uncertainty that will prevail in the meantime will only increase the likelihood of material conflicts between jurisdictions.

It is possible that the conflicts between Chinese and U.S. antitrust law may be much more dramatic than the periodic conflicts between EU and U.S. law. While serious, the conflicts between the EU and U.S. generally occur within relatively narrow analytical boundaries. The conflicts with Chinese law may blow up those boundaries. If so, will U.S. businesses be forced to adopt one strategy in the U.S. and another in China? Perhaps, but depending on the magnitude of the conflict, that may not be practical.

It’s one thing to change a product’s connector port, but it’s quite another to be forced to license technology to a competitor. A U.S. company may be compelled to change a core strategy globally, meaning that Chinese antitrust policy will be the de facto standard across the globe. Sound far-fetched? Not to those who could never have imagined in the wake of World War II that one day America’s second most valuable company would change an important feature of its hottest selling product merely to mollify European regulators.

--By Leiv Blad, Bingham McCutchen LLP

Leiv Blad (leiv.blad@bingham.com) is a partner in Bingham McCutchen’s Washington, D.C., office and co-leader of the firm’s antitrust and trade regulation practice group.

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