**2023 STUDENT UPDATE**
**TRANSNATIONAL BUSINESS PROBLEMS (6th ed.)**

**(1)** On p. 83, at the end of the paragraph, insert the following:

> The United States-Mexico-Canada Agreement (USMCA), which replaced NAFTA on July 1, 2020, passed the Senate by a vote of 89-10.

**(2)** On p. 84, replace the second full paragraph with the following:

> Occasionally, Congress specifies that what otherwise might be self-executing provisions of an international agreement cannot be enforced in court by private parties. USCMA Article 14.4, for example, provides for national treatment of foreign investors from Canada and Mexico. Congress, however, provided in the USMCA's implementing legislation that "[n]o person other than the United States . . . shall have any cause of action or defense under the USMCA" or may challenge any action or inaction of the United States, a state, or a subdivision of a state "on the ground that such action or inaction is inconsistent with the USMCA." United States-Mexico-Canada Agreement Implementation Act § 102(c). Cf. Asakura v. City of Seattle, 265 U.S. 332, 44 S.Ct. 515, 68 L.Ed. 1041 (1924) (holding that national-treatment provision in U.S. treaty with Japan "operates of itself without the aid of any legislation"). The Senate has tried to achieve the same result with respect to Bilateral Investment Treaties after Medellín by giving its advice and consent subject to the declaration that only certain provisions are self-executing and that none confers a private right of action. See Investment Treaty with Rwanda, Treaty Doc. 110–23, at 13 (2010).

**(3)** On p. 90, replace the first three lines with the following:

> "appoint to senior management positions a natural person of a particular nationality." USMCA Art. 14.11; see also 2012 U.S. Model Bilateral Investment Treaty Art. 9(1).

**(4)** On pp. 147-48, replace the last three paragraphs of Chapter IV with the following:

> Subsequent decisions have continued to narrow the ATS cause of action. In Jesner v. Arab Bank, PLC, 138 S.Ct. 1386 (2018), the Court held that the ATS cause of action should not be extended to *foreign* corporations. Id. at 1403, 1407 (opinion of the Court). In Nestlé USA, Inc. v. Doe, 141 S.Ct. 1931 (2021), the Supreme Court considered claims against U.S. corporations alleging that they had aided and abetted child slavery in Côte d'Ivoire by providing technical and financial resources to farms that used children as slaves. Applying the two-step framework for the presumption against extraterritoriality

articulated in RJR Nabisco, Inc. v. European Community, see supra pp. 97-98, rather than Kiobel's "touch and concern" test, the Court held that the claims sought an impermissible extraterritorial application of the ATS. The defendants' conduct within the United States, the Court reasoned, amounted only to general corporate decision-making while all other activity related to the allegations occurred abroad. Id. at 1937.

In addition to the requirement of alleging sufficient conduct in the United States, plaintiffs using the ATS face a number of other obstacles to bringing human rights claims against corporations. It can be difficult to establish personal jurisdiction over the foreign subsidiary that may have been most directly involved in the abuses, see, e.g., Kiobel v. Royal Dutch Petroleum Co., 2008 WL 591869 (S.D.N.Y) (dismissing claims against Shell's Nigerian subsidiary for lack of personal jurisdiction), while general jurisdiction over the parent company will exist only if the "corporation's affiliations with the State are so continuous and systematic as to render it essentially at home in the forum State." Daimler AG v. Bauman, 571 U.S. 117, 139, 134 S.Ct. 746, 187 L.Ed.2d 624 (2014) (international quotation marks omitted). Plaintiffs who are able to establish personal jurisdiction and overcome the presumption against extraterritoriality must still show that their claims meet Sosa's standard for acceptance and specificity and, in the case of aiding and abetting claims, that the defendant acted with the necessary *mens rea*.

In the wake of Kiobel, it is possible that more claims will be brought in state courts, which are subject to the same rules of personal jurisdiction but free from the limits that Sosa and Kiobel have placed on the ATS cause of action. It is also possible that more cases will be filed in foreign courts. In 2013, a Dutch decision found jurisdiction over Shell and its Nigerian subsidiary with respect to claims of environmental harm in Nigeria. Applying Nigerian law, the court held that the parent company was not liable in tort but that the subsidiary had committed negligence by insufficiently securing oil well-heads against sabotage, and was liable for damages. See Akpan v. Royal Dutch Shell Plc, No. 337050 (Hague Dist. Ct. 2013) (Neth.). In 2019, the Supreme Court of the United Kingdom allowed claims to go forward against a U.K. corporation and its Zambian subsidiary seeking damages for toxic emissions from a mine in Zambia. Vedanta Resources PLC v. Lungowe, [2019] UKSC 20. And in 2020, the Supreme Court of Canada held that Canadian corporations may be sued in tort for violations of international human rights law that occur abroad. Nevsun Resources Ltd. v. Araya, 2020 SCC 5.

**(5)** On pp. 156-61, replace the section "2. Domestic Law" with the following:

## 2. Domestic Law

With the important exception of the CISG discussed above, the modern law of sales is domestic law. In the United States, it is state rather than federal law. Nearly every state in the United States has adopted Article 2 of the Uniform Commercial Code (UCC), which applies to transactions in goods. Other transactions are subject to the common law of contracts, which varies

from state to state. In China, contracts are governed by a unified national law, the Civil Code of the People's Republic of China, which went into effect on January 1, 2021 and replaced the 1999 Contract Law. Book Three of the Civil Code has general rules covering all contracts (Chapters I-VIII) and more specific rules for sales contracts (Chapter IX) and other kinds of contracts (Chapters X-XXVII).

The domestic law of contracts will govern if the CISG is not applicable, for example if parties' places of business are not both in CISG countries (e.g., a sale of goods contract between a Taiwanese buyer and a U.S. seller) or if the contract's choice-of-law clause has effectively excluded the CISG. Even when the CISG applies, the domestic law of contracts may also govern questions not covered by the Convention, such as the validity of the contract. See CISG Art. 7(2) ("Questions concerning matters governed by this Convention which are not expressly settled in it are to be settled in conformity with the general principles on which it is based or, in the absence of such principles, in conformity with the law applicable by virtue of the rules of private international law.").

Because the domestic law of contracts differs from jurisdiction to jurisdiction, *which* domestic law governs may significantly affect the rights and duties of the parties and how particular disputes between them will be resolved. If the contract contains a choice-of-law clause, the answer is generally straightforward. Most legal systems will enforce such clauses, subject to only limited exceptions. See, e.g., Restatement (Second) of Conflicts § 187(1) (1971) ("The law of the state chosen by the parties to govern their contractual rights and duties will be applied if the particular issue is one which the parties could have resolved by an explicit provision in their agreement directed to that issue."); UCC § 1–301(a) ("Except as otherwise provided in this section, when a transaction bears a reasonable relation to this state and also to another state or nation the parties may agree that the law either of this state or of such other state or nation shall govern their rights and duties."); Law of the People's Republic of China on Choice of Law for Foreign-Related Civil Relationships Art. 41 ("The parties concerned may choose the laws applicable to contracts by agreement.").

When the contract does not have a choice-of-law clause and the CISG does not apply, a court will use the conflict-of-laws rules of its own jurisdiction to determine the applicable law. In the United States, those would be the conflicts rules of the state in which the court is located, even if the court is a federal court sitting in diversity. Klaxon Co. v. Stentor Electric Mfg. Co., 313 U.S. 487, 61 S.Ct. 1020, 85 L.Ed. 1477 (1941); Day & Zimmermann, Inc. v. Challoner, 423 U.S. 3, 96 S.Ct. 167, 46 L.Ed.2d 3 (1975) (per curiam). Common-law conflicts rules vary from state to state, but more states have adopted the approach of the Restatement (Second) of Conflicts than any other:

**§ 188. Law Governing in Absence of Effective Choice by the Parties**

(1) The rights and duties of the parties with respect to an issue in contract are determined by the local law of the state which, with respect to that issue, has the most significant relationship to the transaction and the parties under the principles stated in § 6.

(2) In the absence of an effective choice of law by the parties (see § 187), the contacts to be taken into account in applying the principles of § 6 to determine the law applicable to an issue include:

(a) the place of contracting,

(b) the place of negotiation of the contract,

(c) the place of performance,

(d) the location of the subject matter of the contract, and

(e) the domicil, residence, nationality, place of incorporation and place of business of the parties.

These contacts are to be evaluated according to their relative importance with respect to the particular issue.

(3) If the place of negotiating the contract and the place of performance are in the same state, the local law of this state will usually be applied, except as otherwise provided in §§ 189–199 and 203.

**§ 6. Choice-of-Law Principles**

(1) A court, subject to constitutional restrictions, will follow a statutory directive of its own state on choice of law.

(2) When there is no such directive, the factors relevant to the choice of the applicable rule of law include

(a) the needs of the interstate and international systems,

(b) the relevant policies of the forum,

(c) the relevant policies of other interested states and the relative interests of those states in the determination of the particular issue,

(d) the protection of justified expectations,

(e) the basic policies underlying the particular field of law,

(f) certainty, predictability and uniformity of result, and

(g) ease in the determination and application of the law to be applied.

In sale-of-goods cases, the common law of conflicts has been superseded by UCC § 1–301(b), which directs courts to apply the UCC "to transactions bearing an appropriate relation to this state." Note that a transaction may bear an "appropriate relation" to a state even if that state does not have the "most significant relationship" to the transaction. The UCC adopted this expansive conflicts rule to increase the number of cases to which the UCC would apply during its early days.

The 2010 Chinese Law on Choice of Law for Foreign-Related Civil Relationships also contains an article on applicable law, which provides a test for choosing the law in the absence of a choice by the parties:

> **Article 41.** The parties concerned may choose the laws applicable to contracts by agreement. If the parties do not choose, the laws at the habitual residence of the party whose fulfillment of obligations can best reflect the characteristics of this contract or other laws which have the closest relation with this contract shall apply.

The phrase "party whose fulfillment of the obligations can best reflect the characteristics of this contract" reflects the influence of Swiss law, which developed a concept of "characteristic performance" that has also been adopted in the European Union by the Rome I Regulation, 2008 O.J. (L 177) 6. The characteristic performance in a contract is typically the performance that is not the payment of money. In a sales contract, therefore, unless the parties choose a different law, the law of the seller's habitual residence would apply.

Does it make a difference which domestic law of contracts is applied? There are some similarities in the commercial laws of different countries, due in part to cross-system borrowing. For example, some German influences infiltrated the UCC through one of its drafters, Karl Llewellyn, and China's first modern civil code was heavily influenced by German law. The drafters of China's 1999 Contract Law deliberately looked to the "beneficial experience of foreign countries," and many of that law's provisions closely followed the UNIDROIT Principles of International Commercial Contracts and the CISG. In 2021, the 1999 Contract Law was superseded by the contracts provisions of China's Civil Code, but the Civil Code retained much of the earlier law's substance. Still, domestic laws often diverge, because they arise from different legal cultures and respond to different commercial environments. Thus, a given controversy between a buyer and seller could come out differently under different systems. We examine three constellations of problems not unknown in domestic sales law but likely to be particularly acute in transborder dealings.

For one example, suppose that the buyer asserts, after the goods have arrived, that they are not up to standard. One question is: what is the standard? UCC § 2–313 provides for the enforcement of express warranties, while § 2–314 and § 2–315 provide for implied warranties of merchantability and fitness for a particular purpose. For sales contracts, Article 615 of China's Civil Code provides: "A seller shall deliver the subject matter in conformity with the quality requirements as agreed by the parties." Where there is no agreement Article 616 refers back to Article 511(1) in the general rules on contracts, which reads as follows:

> the contract shall be performed in accordance with a mandatory national standard, or a recommendatory national standard in the absence of a mandatory national standard, or the standard of the industry in the absence of a recommendatory national standard. In the absence of any national or industrial standards, the contract shall be performed in accordance with the general standard or a specific standard conforming to the purpose of the contract.

The references to "the standard of the industry" and "a specific standard conforming to the purpose of the contract" are roughly equivalent to the UCC's warranties of merchantability and fitness for a particular purpose. But note that these standards are subordinate to mandatory and recommended national standards.

Under the UCC's "perfect tender rule," a buyer has the right to reject a shipment of goods if they fail in any way to conform to the contract. UCC § 2-601. The buyer must seasonably notify the seller of the rejection and must follow any reasonable instructions from the seller with respect to the goods. UCC §§ 2-602 & 2-603. The buyer may seek as damages the difference between the contract price of the goods and either the market price or the "cover" price, as well as incidental and consequential damages, UCC §§ 2-712 to 2-715, but generally may not seek specific performance of the contract unless the goods are unique, UCC § 2-716. Under Article 610 of China's Civil Code, there is no perfect tender rule for sales contracts; a buyer may refuse delivery or rescind the contract only "[w]here a subject matter fails to meet the quality requirements so that the purpose of the contract cannot be achieved." The buyer is required to inspect the goods (Article 620) and must notify the seller of any non-conformity within the agreed inspection period or, if no such period has been agreed, within a reasonable time not exceeding two years (Article 621). The Civil Code's general rules on remedies provide for expectation damages, including foreseeable consequential damages (Article 584). Liquidated damages are permitted although a court may adjust these if they prove higher or lower than the actual damages (Article 585). And specific performance is more readily available than under the UCC because there is no requirement that the goods be unique (Article 580).

Standard terms that limit remedies are also treated differently. Under UCC § 2–719 the seller may limit the buyer's remedies to repayment of the price and may exclude consequential damages unless the limitation is unconscionable, for example an exclusion for personal injuries in the case of consumer goods. Article 496 of China's Civil Code requires a party using a standard clause "concerning the other party's major interests and concerns, such as a clause that exempts or alleviates the liability of the party providing the standard clause," to call that clause to the other party's attention and give explanations upon the other party's request. If the first party fails to do so, "the other party may claim that such clause does not become part of the contract." Article 497 goes further and provides that a standard clause is void if "the party providing the standard clause unreasonably exempts or alleviates himself from the liability, imposes heavier liability on the other party, or restricts the main rights of the other party."

A second set of issues characteristic of international transactions is the problem of unexpected changes in conditions. For example, in 1956 hostilities in the Middle East closed the Suez Canal for a protracted period (a much longer period than in 2021). All sorts of contractual arrangements were upset by this. The Uniform Commercial Code's provision on impracticability is set forth in § 2–615, which provides in part: "Delay in delivery or non-delivery in whole or in part by a seller . . . is not a breach of his duty under a contract for sale if performance as agreed has been made impracticable by the occurrence of a contingency the non-occurrence of which was a basic assumption on which the contract was made or by compliance in good faith with any applicable foreign or domestic government regulation or order whether or not it later proves to be invalid." Article 590 of China's Civil Code provides a defense of *force majeure*, but Article 180 defines "*force majeure*" narrowly as "objective conditions which are unforeseeable, unavoidable, and insurmountable." However, Article 533 contains a broader provision that applies if "a fundamental

condition" has "significantly changed" and "continuing performance of the contract is obviously unfair to one of the parties." In that event, the adversely affected party may renegotiate the contract and, if the parties cannot reach agreement, may "may request the people's court or an arbitration institution to rectify or rescind the contract."

Third, we have what is called "the battle of the forms." A buyer orders goods using its standard purchase order form, and the seller responds with its standard acknowledgment form or invoice, which contains additional or different terms. Is there a contract? What are its terms? The UCC departed from the common law's "mirror image rule" by providing that a reply that varied the terms of the offer could be an acceptance:

> **§ 2–207. Additional Terms in Acceptance or Confirmation**
>
> (1) A definite and seasonable expression of acceptance or a written confirmation which is sent within a reasonable time operates as an acceptance even though it states terms additional to or different from those offered or agreed upon, unless acceptance is expressly made conditional on assent to the additional or different terms.
>
> (2) The additional terms are to be construed as proposals for addition to the contract. Between merchants such terms become part of the contract unless:
>
> (a) the offer expressly limits acceptance to the terms of the offer;
>
> (b) they materially alter it; or
>
> (c) notification of objection to them has already been given or is given within a reasonable time after notice of them is received.
>
> (3) Conduct by both parties which recognizes the existence of a contract is sufficient to establish a contract for sale although the writings of the parties do not otherwise establish a contract. In such case the terms of the particular contract consist of those terms on which the writings of the parties agree, together with any supplementary terms incorporated under any other provisions of this Act.

The relevant provisions of China's Civil Code, although allowing an acceptance to make some non-material modifications to an offer, are much closer in effect to the "mirror image rule" of the common law and to Article 19 of the CISG:

> **Article 488.** The content of an acceptance shall be consistent with the content of the offer. Where the offeree proposes in the acceptance any material alteration to the content of the offer, it shall constitute a new offer. An alteration concerning the object of the contract, the quantity, quality, price or remuneration, time period of performance, place and manner of performance, default liability, the methods of dispute resolution, or the like is a material alteration to the content of an offer.
>
> **Article 489.** Where an acceptance makes a non-material alteration to the offer, the acceptance shall be effective and the content of the contract shall be as altered by the acceptance, unless the offeror objects in time, or the offer indicates that an acceptance may not make any alteration to the content of the offer.

**(6)** On p. 187, after the heading "D. U.S. Regulation of Export Trade," insert the following:

> The United States regulates export trade extensively to protect U.S. national security and to promote strategic objectives. Currently, the Department of the Treasury administers 37 active sanctions programs, including sanctions on Cuba, Iran, and Russia. Even before Russia's invasion of Ukraine, the Treasury Department reported that sanctions designations by its Office of Foreign Assets Control have increased 933% since 2000. See U.S. Dept. of Treasury, The Treasury 2021 Sanctions Review 2 (2021).

**(7)** On p. 192, after the first full paragraph, insert the following:

> On October 7, 2022, the BIS expanded its export control policies towards China to protect U.S. national security and foreign policy interests. The controls restrict China's access to advanced computing chips through several methods, including an expansion of the CCL. The policy adds three new ECCNs to the CCL for advanced computing chips, products containing advanced computing chips, and products used to manufacture advanced chips. The regulations further create a new reason for control under Regional Stability, which applies directly to the export and reexport of the new items to China.

**(8)** On p. 203, second full paragraph, third line, replace "NAFTA" with "USMCA."

**(9)** On p. 220, at the end of the first paragraph, add the following:

> In 2020, the United Kingdom withdrew from the EU, reducing the total membership to 27 countries.

**(10)** On pp. 241-47, beginning on p. 241 at the fourth paragraph and ending on p. 247 before the word "Questions," replace the text with the following:

> In Consten and Grundig v. Commission, [1966] E.C.R. 299, the European Court of Justice held that vertical distribution agreements came within the scope of Article 101 (then Article 85). In 1967 the Commission issued its first block exemption, Regulation 67/67, 1967 O.J. 10, which spelled out conditions under which Article 101 would not be regarded as applicable to distribution agreements. The current block exemption, known as the Vertical Block Exemption Regulation 2022/720, 2022 O.J. (L 134) 4, entered into force on June 1, 2022.

The Regulation's recitals recognize the procompetitive aspects of distribution agreements:

(6) Certain types of vertical agreements can improve economic efficiency within a chain of production or distribution by facilitating better coordination between the participating undertakings. In particular, they can lead to a reduction in the transaction and distribution costs of the parties and to an optimisation of their sales and investment levels.

(7) The likelihood that such efficiency-enhancing effects will outweigh any anti-competitive effects due to restrictions contained in vertical agreements depends on the degree of market power of the parties to the agreement and, in particular, on the extent to which those undertakings face competition from other suppliers of goods or services regarded by their customers as interchangeable or substitutable for one another, by reason of the products' characteristics, their prices and their intended use.

(8) It can be presumed that, where the market share held by each of the undertakings party to the agreement on the relevant market does not exceed 30%, vertical agreements which do not contain certain types of severe restrictions of competition generally lead to an improvement in production or distribution and allow consumers a fair share of the resulting benefits.

The block exemption declares that Article 101(1) is not applicable to vertical agreements—that is, agreements between entities that operate at different levels in the chain of production or distribution—so long as each party's market share does not exceed 30%. Article 4 contains a list of "hardcore restrictions"—contractual terms that will cause the agreement to lose the protection of the block exemption. Article 5 contains a further list of "excluded restrictions"—terms that will not take the entire agreement outside the scope of the block exemption but that are not themselves exempt from Article 101(1) and that therefore may be unenforceable under Article 101(2). If an agreement or term falls outside the scope of the block exemption, it must be analyzed under Article 101 on an individual basis. On the one hand, there is no presumption that a vertical agreement falling outside the block exemption because the market share thresholds are exceeded will violate Article 101. On the other hand, there is a presumption that agreements containing hardcore restrictions violate Article 101.

## Commission Regulation (EU) 2022/720 of 10 May 2022 on the Application of Article 101(3) of the Treaty on the Functioning of the European Union to Categories of Vertical Agreements and Concerted Practices

2022 O.J. (L 134) 4

* * *

*Article 1*

Definitions

1. For the purposes of this Regulation, the following definitions shall apply:

   (a) 'vertical agreement' means an agreement or concerted practice between two or more undertakings, each of which operates, for the purposes of the agreement or the concerted practice, at a different level of the production or distribution chain, and relating to the conditions under which the parties may purchase, sell or resell certain goods or services;

   (b) 'vertical restraint' means a restriction of competition in a vertical agreement falling within the scope of Article 101(1) of the Treaty;

   (c) 'competing undertaking' means an actual or potential competitor; 'actual competitor' means an undertaking that is active on the same relevant market; 'potential competitor' means an undertaking that, in the absence of the vertical agreement, would, on realistic grounds and not just as a mere theoretical possibility, be likely, within a short period of time, to make the necessary additional investments or incur other necessary costs to enter the relevant market;

* * *

   (f) 'non-compete obligation' means any direct or indirect obligation causing the buyer not to manufacture, purchase, sell or resell goods or services which compete with the contract goods or services, or any direct or indirect obligation on the buyer to purchase from the supplier or from another undertaking designated by the supplier more than 80% of the buyer's total purchases of the contract goods or services and their substitutes on the relevant market, calculated on the basis of the value or, where such is standard industry practice, the volume of its purchases in the preceding calendar year;

   (g) 'selective distribution system' means a distribution system where the supplier undertakes to sell the contract goods or services, either directly or indirectly, only to distributors selected on the basis of specified criteria and where these distributors undertake not to sell such goods or services to unauthorised distributors within the territory reserved by the supplier to operate that system;

   (h) 'exclusive distribution system' means a distribution system where the supplier allocates a territory or group of customers exclusively to itself or to a maximum of five buyers and restricts all its other buyers from actively selling into the exclusive territory or to the exclusive customer group;

* * *

   (l) 'active sales' means actively targeting customers by visits, letters, emails, calls or other means of direct communication or through targeted advertising and promotion, offline or online, for instance by means of print or digital media, including online

media, price comparison services or advertising on search engines targeting customers in particular territories or customer groups, operating a website with a top-level domain corresponding to particular territories, or offering on a website languages that are commonly used in particular territories, where such languages are different from the ones commonly used in the territory in which the buyer is established;

(m) 'passive sales' means sales made in response to unsolicited requests from individual customers, including delivery of goods or services to the customer, without the sale having been initiated by actively targeting the particular customer, customer group or territory, and including sales resulting from participating in public procurement or responding to private invitations to tender.

* * *

*Article 2*

Exemption

1. Pursuant to Article 101(3) of the Treaty and subject to the provisions of this Regulation, it is hereby declared that Article 101(1) of the Treaty shall not apply to vertical agreements. This exemption shall apply to the extent that such agreements contain vertical restraints.

2. The exemption provided for in paragraph 1 shall apply to vertical agreements entered into between an association of undertakings and an individual member, or between such an association and an individual supplier, only if all the members of the association are retailers of goods and if no individual member of the association, together with its connected undertakings, has a total annual turnover exceeding EUR 50 million. Vertical agreements entered into by such associations shall be covered by this Regulation without prejudice to the application of Article 101 of the Treaty to horizontal agreements concluded between the members of the association or decisions adopted by the association.

3. The exemption provided for in paragraph 1 shall apply to vertical agreements containing provisions which relate to the assignment to the buyer or use by the buyer of intellectual property rights, provided that those provisions do not constitute the primary object of such agreements and are directly related to the use, sale or resale of goods or services by the buyer or its customers. The exemption applies on the condition that, in relation to the contract goods or services, those provisions do not contain restrictions of competition having the same object as vertical restraints which are not exempted under this Regulation.

4. The exemption provided for in paragraph 1 shall not apply to vertical agreements entered into between competing undertakings. However, that exemption shall apply where competing undertakings enter into a non-reciprocal vertical agreement and one of the following applies:

(a) the supplier is active at an upstream level as a manufacturer, importer, or wholesaler and at a downstream level as an importer, wholesaler, or retailer of goods, while the buyer is

an importer, wholesaler, or retailer at the downstream level and not a competing undertaking at the upstream level where it buys the contract goods; or

(b) the supplier is a provider of services at several levels of trade, while the buyer provides its services at the retail level and is not a competing undertaking at the level of trade where it purchases the contract services.

* * *

7. This Regulation shall not apply to vertical agreements the subject matter of which falls within the scope of any other block exemption regulation, unless otherwise provided for in such a regulation.

## *Article 3*

### Market share threshold

1. The exemption provided for in Article 2 shall apply on condition that the market share held by the supplier does not exceed 30% of the relevant market on which it sells the contract goods or services and the market share held by the buyer does not exceed 30% of the relevant market on which it purchases the contract goods or services.

2. For the purposes of paragraph 1, where in a multi-party agreement an undertaking buys the contract goods or services from one undertaking that is a party to the agreement and sells the contract goods or services to another undertaking that is also a party to the agreement, the market share of the first undertaking must respect the market share threshold provided for in that paragraph both as a buyer and a supplier in order for the exemption provided for in Article 2 to apply.

## *Article 4*

### Restrictions that remove the benefit of the block exemption - hardcore restrictions

The exemption provided for in Article 2 shall not apply to vertical agreements which, directly or indirectly, in isolation or in combination with other factors under the control of the parties, have as their object:

(a) the restriction of the buyer's ability to determine its sale price, without prejudice to the possibility of the supplier to impose a maximum sale price or recommend a sale price, provided that they do not amount to a fixed or minimum sale price as a result of pressure from, or incentives offered by, any of the parties;

(b) where the supplier operates an exclusive distribution system, the restriction of the territory into which, or of the customers to whom, the exclusive distributor may actively or passively sell the contract goods or services, except:

(i) the restriction of active sales by the exclusive distributor and its direct customers, into a territory or to a customer group reserved to the supplier or allocated by the supplier exclusively to a maximum of five other exclusive distributors;

(ii) the restriction of active or passive sales by the exclusive distributor and its customers to unauthorised distributors located in a territory where the supplier operates a selective distribution system for the contract goods or services;

(iii) the restriction of the exclusive distributor's place of establishment;

(iv) the restriction of active or passive sales to end users by an exclusive distributor operating at the wholesale level of trade;

(v) the restriction of the exclusive distributor's ability to actively or passively sell components, supplied for the purposes of incorporation, to customers who would use them to manufacture the same type of goods as those produced by the supplier;

* * *

(e) the prevention of the effective use of the internet by the buyer or its customers to sell the contract goods or services, as it restricts the territory into which or the customers to whom the contract goods or services may be sold within the meaning of points (b), (c) or (d), without prejudice to the possibility of imposing on the buyer:

(i) other restrictions of online sales; or

(ii) restrictions of online advertising that do not have the object of preventing the use of an entire online advertising channel;

* * *

*Article 5*

Excluded restrictions

1. The exemption provided for in Article 2 shall not apply to the following obligations contained in vertical agreements:

(a) any direct or indirect non-compete obligation, the duration of which is indefinite or exceeds 5 years;

(b) any direct or indirect obligation causing the buyer, after termination of the agreement, not to manufacture, purchase, sell or resell goods or services;

(c) any direct or indirect obligation causing the members of a selective distribution system not to sell the brands of particular competing suppliers;

(d) any direct or indirect obligation causing a buyer of online intermediation services not to offer, sell or resell goods or services to end users under more favourable conditions via competing online intermediation services;

2. By way of derogation from paragraph 1, point (a), the time limitation of five years shall not apply where the contract goods or services are sold by the buyer from premises and land

owned by the supplier or leased by the supplier from third parties not connected with the buyer, provided that the duration of the non-compete obligation does not exceed the period of occupancy of the premises and land by the buyer.

3. By way of derogation from paragraph 1, point (b), the exemption provided for in Article 2 shall apply to any direct or indirect obligation causing the buyer, after termination of the agreement, not to manufacture, purchase, sell or resell goods or services where all of the following conditions are fulfilled:

(a) the obligation relates to goods or services which compete with the contract goods or services;

(b) the obligation is limited to the premises and land from which the buyer has operated during the contract period;

(c) the obligation is indispensable to protect know-how transferred by the supplier to the buyer;

(d) the duration of the obligation is limited to a period of one year after termination of the agreement.

Paragraph 1, point (b) shall be without prejudice to the possibility of imposing a restriction which is unlimited in time on the use and disclosure of know-how which has not entered the public domain.

---

In 1962, the Commission issued an official notice stating that generally agreements with commercial agents would not fall within Article 101(1) (then Article 85(1)). 1962 O.J. 2921. In connection with the adoption of the Vertical Block Exemption Regulation, the Commission in 2022 issued new Guidelines on Vertical Restraints, paragraphs 29–46 of which discuss the applicability of Article 101(1) to agents. An intermediary will be considered a genuine agent for the purposes of Article 101(1) "where the agent bears no significant financial or commercial risks in relation to the contracts concluded or negotiated on behalf of the principal." Title to the goods must not vest in the agent, and the agent must not contribute to the cost of purchasing or transporting the goods, maintain stocks of the goods at its own cost or risk, take responsibility for the customer's non-performance of the contract, assume responsibility towards third parties for damage caused by the goods, be obliged to invest in sales promotion, or make market-specific investments in equipment, premises, training of personnel, or undertake other activities within the same product market unless those activities are reimbursed by the principal.

If an agency agreement meets these conditions, "all obligations imposed on the agent in relation to the contracts concluded and/or negotiated on behalf of the principal fall outside Article 101(1) of the Treaty." In particular, an agency agreement may include territorial restrictions and prices and conditions at which the agent must sell the goods. Provisions relating to the relationship between the agent and the principal, on the other hand, may infringe

Article 101(1). "Exclusive agency provisions will, in general, not result in anti-competitive effects. However, single branding provisions and post-term non-compete provisions, which concern inter-brand competition, may restrict competition within the meaning of Article 101(1) of the Treaty where, in isolation or by way of cumulative effects, they result in foreclosure of the relevant market where the contract goods or services are sold or purchased."

Apart from Article 101(1), the Agency Directive, also limits non-compete obligations following termination of an agreement:

*Article 20*

1. For the purposes of this Directive an agreement restricting the business activities of a commercial agent following termination of the agency contract is hereinafter referred to as a restraint of trade clause.

2. A restraint of trade clause shall be valid only if and to the extent that:

   (a) it is concluded in writing and

   (b) it relates to the geographical area or the group of customers and the geographical area entrusted to the commercial agent and to the kind of goods covered by his agency under the contract.

3. A restraint of trade clause shall be valid for not more than two years after termination of the agency contract.

4. This Article shall not affect provisions of national law which impose other restrictions on the validity or enforceability of restraint of trade clauses or which enable the courts to reduce the obligations on the parties resulting from such an agreement.

**(11)** On p. 266, replace the second full sentence with the following:

The same limitation applies in the cases of the other three types of intellectual property. For many years, the Supreme Court allowed lower courts to apply the Lanham Act to trademark infringement outside the United States that affected U.S. commerce. But in Abitron Austria GmbH v. Hetronic International, Inc., 2023 WL 4239255 (2023), the Supreme Court held that the Lanham Act applies only when the infringing trademark is used in commerce in the United States.

**(12)** On p. 309, replace the third full paragraph with the following:

The decision whether to operate through a branch or a subsidiary may also affect the applicability of various treaties designed to protect foreign investors. As noted above, the U.S. Supreme Court held in the Sumitomo case that a New York subsidiary of a Japanese company was not entitled to claim the benefits of the U.S.-Japan Friendship,

Commerce, and Navigation Treaty because under the terms of the treaty the subsidiary was a company of the United States rather than a company of Japan. See supra pp. 85–90. Chapter Fourteen of the USMCA, by contrast, applies to "investors of another Party" and to "covered investments." Under USMCA Article 14.1 "investment" includes "an enterprise," and under Article 1.5 "enterprise" means "an entity constituted or organized under applicable law," including a subsidiary organized under the law of the host state. The same tends to be true of other U.S. international investment agreements (IIAs). See U.S. Model Bilateral Investment Treaty art. 1 (2012) (defining "investment" and "enterprise" in similar terms). Problem 7 discusses the protection of foreign investment under IIAs in greater detail. See infra pp. 470–482.

**(13)** On p. 318, replace the last sentence of the runover paragraph with the following.

NAFTA was replaced by the USMCA on July 1, 2020. Like NAFTA, the USMCA provides protections for Canadian and U.S. investors in Mexico (and vice versa), although its system of arbitration for resolving disputes is more limited.

**(14)** On pp. 397-433, replace Problem 6 with the following:

# PROBLEM 6

# AN INTERNATIONAL JOINT VENTURE

## A. INTRODUCTION

Joint ventures may be defined broadly as common projects between independent parties, usually companies, that share both the management responsibilities and the financial risks. Joint ventures fall into two basic legal categories: "equity joint ventures" in which the parties establish another corporation in which they both own interests; and "contractual joint ventures" in which the parties do not establish another corporation but simply specify their rights and obligations by contract, constituting in effect a partnership.

Sharing control can be difficult, and there seem to be two principal reasons why firms agree to do it. First, government regulation may require foreign investment to take the form of a joint venture either generally or in particular areas of the economy. Recall Mexico's Foreign Investment Act, considered in Problem 4, supra pp. 318–329, which limits foreign investment to specified percentages in such sectors as air transportation and domestic newspapers. A foreign investor who wishes to operate in one of these areas has no choice but to find a local partner.

Second, even when not required by law, two companies may choose to enter a joint venture because neither company alone has all of the ingredients necessary to make the venture succeed. Foreign investors frequently seek out local partners who are familiar with local conditions (including government regulations and the bureaucracy that administers them), local supply chains, local product markets, channels for distribution, labor conditions, and local customs. The local partner might also bring to the joint venture existing production and distribution facilities and an established reputation. The foreign partner, on the other hand, is generally expected to contribute to the joint venture its technology, management skills, financing, and perhaps access to markets for export.

In China, joint ventures were the original vehicles for encouraging foreign investment in the post-Mao era. China adopted a Law on Chinese-Foreign Equity Joint Ventures in 1979 and a Law on Chinese-Foreign Contractual Joint Ventures in 1988. Starting in 1990, China also permitted Wholly Foreign-Owned Enterprises (WFOEs). With the lifting of many restrictions on foreign investment following China's 2001 accession to the WTO, WFOEs became the preferred vehicle for foreign investment in China. Still, in the years leading up to 2020, China approved more than 6,000 equity joint ventures annually.

In 2019, China adopted a new Foreign Investment Law (FIL), discussed below. One of the aims of the law was to unify the approach for all types of foreign investment in China. Accordingly, the FIL repealed the separate laws on equity joint ventures, contractual joint ventures, and wholly foreign-owned enterprises effective January 1, 2020. In response, foreign investors wanting to establish joint ventures are now forming limited liability companies with Chinese partners under the Company Law of the People's Republic of China.

A number of issues tend to be of particular importance in negotiating joint ventures. The first is control. Will the foreign and the local partner each own 50% of an equity joint venture, for example, or will there be a majority and a minority partner? If there is to be a minority partner, will its interests be protected by requiring a supermajority or unanimity for certain decisions? How will responsibilities be divided between the board of directors and the joint venture's managers, and how will the latter be selected? A second important issue is technology transfer. What technologies will the foreign partner license to the joint venture? How will their use be restricted to protect the foreign partner's intellectual property rights? Who will own new technologies or improvements developed by the joint venture? A third is valuation. Assuming that the parties bring assets other than cash to the joint venture—intellectual property rights or an existing distribution network, for example—how is each party's contribution to be valued? A fourth is dispute resolution. Differences may be expected to develop over the life of the joint venture, and if these differences cannot be resolved through negotiation, should they be submitted to arbitration or taken to court? And a fifth is exit, that is, how a party may leave the joint venture. May it sell its interest to a third party? If so, should the other partner be given a right of first refusal? May the joint venture continue to use technology from the foreign partner after it leaves the joint venture?

From a tax perspective, a joint venture may generally elect to be treated either as a corporation or as a partnership under the IRS's check-the-box regulations, so long as the joint venture does not take a form the IRS considers a *per se* corporation.[1] In Europe, the German *Aktiengesellschaft*, the French *Société Anonyme*, and the Spanish *Sociedad Anónima* are *per se* corporations. In China, the *Gufen Youxian Gongsi* (variously translated as "joint stock company" or "company limited by shares") is a *per se* corporation, but the *Youxian Zeren Gongsi* (limited liability company) is not. In the past, to encourage foreign investment, China provided tax incentives to foreign-invested enterprises, including joint ventures and wholly foreign-owned enterprises. Since 2008, however, China has unified its tax treatment of foreign and domestic enterprises, both of which are now taxed at a basic rate of 25%. Tax breaks are still available for foreign investment in

[1] See 26 C.F.R. §§ 301.7701–1, –2, and –3.

certain encouraged industries and in the central and western regions of China.

Section B sets forth a sample joint venture agreement creating a limited liability company under the Company Law of the People's Republic of China. As you read it, consider how each of the issues mentioned above is treated. Section C discusses the legal framework for foreign investment in China. Section D considers some of the tensions that may be expected to arise over the life of a joint venture and some methods for resolving disputes. And Section E discusses some of the problems that joint ventures raise under antitrust law in various jurisdictions.

## B. A U.S.-CHINESE JOINT VENTURE AGREEMENT

The establishment of a joint venture typically proceeds through several steps. The first, and probably the most important, is the identification of an appropriate joint venture partner. For the foreign party, this means finding a local partner that can bring to the joint venture those things that the foreign party lacks, such as good working relationships with the local bureaucracy, a local supply chain, experience in local markets, and perhaps established production facilities or distribution networks. After preliminary negotiations, the parties may then sign a non-binding letter of intent or memorandum of understanding.[2]

The parties will then negotiate a "joint venture agreement" establishing a limited liability company. Prior to 2016, foreign-invested entities—including joint ventures—were required to obtain approval from China's Ministry of Commerce (MOFCOM) before registering. Since October 1, 2016, however, foreign-invested entities need only register online unless they operate in an industry on the so-called "negative list."

As a focus for discussion, consider the following sample joint venture contract. Note that this is a very simple joint venture contract and that many such contracts will be significantly longer and more complex.

### Joint Venture Agreement

This Joint Venture Agreement ("Agreement") is made on _____ 20__ (the "Effective Date") by and between People's Manufacturing Corporation ("People's"), a limited liability company, organized and existing under the laws of China, with its registered address at 75 Nanjing Road, Tianjin, People's Republic of China; and American Hair Products, Inc. ("American"), a corporation organized and existing under the laws of the State of Delaware, United States of America, with its

[2] On negotiating in China, see Graham & Lam, The Chinese Negotiation, in Harvard Business Review on Doing Business in China (2004).

registered address at 500 Spring Street, Los Angeles, California, United States of America.

The Parties have agreed to establish a joint venture company (the "Company") for the purpose of engaging in the Business.

This Agreement sets out the terms agreed by the Parties with respect to the establishment, governance, and management of the Company and the operation of the Business.

Now therefore, after friendly consultations conducted in accordance with the principles of equality and mutual benefit, the Parties hereby agree as follows:

1. *Establishment of the Company*

The Company shall be established in accordance with the terms and provisions of this Agreement. The name of the Company shall be Double Happiness Hair Products LLC, with its registered address at 75 Nanjing Road, Tianjin, People's Republic of China. The Company shall be established as a limited liability company under the laws of the People's Republic of China.

2. *Business of the Company*

The scope of business of the Company shall include the manufacturing of hair care products (the "Business"). The Parties shall cause the Company to conduct the Business in China (the "Territory") and such additional jurisdictions as the Board may approve by Unanimous Board Resolution, subject to compliance with the requirements of Applicable Law.

3. *Capitalization of the Company*

The registered capital of the Company ("Registered Capital") shall be RMB 100 million (*i.e.* U.S. $15 million). People's shall hold 40% of the Registered Capital and American shall hold 60% of the Registered Capital. In consideration of such allocations of the Registered Capital, the Parties shall make the following capital contributions to the Company: (a) People's shall contribute to the Company RMB 40 million in cash; (b) American shall contribute to the Company RMB 40 million in cash and RMB 20 million in intellectual property rights and proprietary technology.

4. *Transfer of Equity Interests*

Either Party may transfer all or part of its Equity Interests to a Qualified Affiliate without restriction. If either Party proposes to transfer all or part of its Equity Interests to a Proposed Transferee other than a Qualified Affiliate, it must first obtain the prior written consent of the other Party, and the other Party shall have a Right of First Refusal to purchase the Designated Equity Interests.

5. *Shareholders Meetings and Resolutions*

5.1 The Shareholders Meeting is the highest authority of the Company. The first meeting of the shareholders shall be held within five Business Days following the Business Licence Issuance Date. The Parties shall cause the Company to hold an annual general meeting of the shareholders. Interim meetings of the shareholders may be held as requested by more than one third of the Directors of the Board, at the request of a Party (so long as it holds 10% or more of the Registered Capital of the Company), or at the request of a Supervisor.

5.2 Approval of resolutions in respect of the following matters shall be by shareholders representing more than two-thirds of the Voting Rights of the Company (each a "Supermajority Shareholders Resolution"):

(a) amendment of the Articles of Association;

(b) any Capital Increase or Capital Reduction;

(c) merger, amalgamation or other combination of the Company with any other entity or company;

(d) division the Company into two or more separate legal entities;

(e) dissolution, winding up or liquidation of the Company;

(f) conversion of the corporate form of the Company;

(g) such other matters which require Supermajority Shareholders Resolution as provided in this Agreement or under Applicable Law.

5.3 The following matters shall be approved by Simple Majority Shareholders Resolution:

(a) election of the Directors and the Supervisors;

(b) the approval of the annual budget and financial reports of the Company;

(c) the determination of the annual allocations to the Company's discretionary accumulation fund;

(d) the approval of the retention of earnings and distribution of Distributable Profits by way of dividends in accordance with the terms of this Agreement;

(e) the approval of all other matters which require shareholder approval under Applicable Law other than such matters which require Supermajority Shareholders Resolution as provided in this Agreement or under Applicable Law.

5.4 If a Shareholder Deadlock Matter arises, a Party may, within twenty Business Days after the meeting of the shareholders at which the Shareholder Deadlock Matter arose, request a subsequent interim meeting of the shareholders to reconsider the Shareholder Deadlock Matter. If the Shareholder Deadlock Matter is not resolved at or before

the interim meeting, then a Party shall have the right to submit a Termination Notice in accordance with the provisions of Paragraph 12. No Shareholder Deadlock Matter may be referred by a Party for determination by arbitration pursuant to Paragraph 20.

6. *Board of Directors*

6.1 The Parties shall cause the Company to establish a Board of Directors to be responsible for the supervision and management of the Company and the Business in accordance with the terms of this Agreement, the Articles of Association and Applicable Law. The Board shall consist of five directors. People's shall have the right to nominate two of the Directors and American shall have the right to nominate three of the Directors. Each Director shall serve for a renewable term of three years. Each Party shall exercise all of its Voting Rights at any regular or interim meeting of the shareholders to elect to the Board each person nominated as a Director by a Party in accordance with this Agreement (including any successor or replacement Director).

6.2 A Director nominated by American shall serve as Chairman and a Director nominated by People's shall serve as Vice Chairman. The Chairman shall be the legal representative of the Company (the "Legal Representative"). The Legal Representative shall not perform any act binding on the Company without the prior approval and authorisation of the Shareholders Meeting or the Board, as the case may be.

7. *Board Meetings and Resolutions*

7.1 The first Board meeting shall be held within five Business Days following the Business Licence Issuance Date, and may be held on the same day as the first meeting of the shareholders following the conclusion of the business of the first meeting of the shareholders. Regular Board meetings shall be held at least two times per year. An interim Board meeting shall be scheduled upon the written request of two or more of the Directors of the Company. Board meetings may be attended by Directors in person, by proxy or by telecommunications. If a Director is unable to participate in a Board meeting in person or by telecommunications, he may issue a written proxy and entrust a representative to participate in the meeting on his behalf. No fewer than four Directors of the Company, present in person, by proxy or by telecommunications shall constitute a quorum necessary for the conduct of business at a meeting of the Board.

7.2 Approval of the following matters shall be by Unanimous Board Resolution:

(a) the adoption of the Business Plan and approval of (i) material amendments thereto and (ii) any Material Transactions outside the approved scope of thereof;

(b) formulation of proposals in respect of the retention of earnings and distribution of Distributable Profits by way of dividends in

accordance with the terms of this Agreement, and submission of the same to the Shareholders Meeting for approval;

(c) establishment of a Subsidiary;

(d) sale or other disposition of, or granting of an Encumbrance over, all or substantially all of the Business or the assets of the Company;

(e) commencement or settlement of any Legal Action or agreement to assume any liability with a value in excess of RMB 200,000;

(f) the Company's entering into, amending, terminating or waiving any rights under, any agreement in respect of a Material Transaction, or a Related Party Transaction with any Party, Party Affiliate or Management Personnel;

(g) such other matters which require Unanimous Board Resolution as provided in this Agreement or under Applicable Law.

7.3 Approval of the following matters shall be by Simple Majority Board Resolution:

(a) formulation of proposals in respect of the Company's annual budgets and financial reports, and submission of the same to the Shareholders Meeting for reference and/or action as appropriate;

(b) review and approval of the Company's annual production and operation plans;

(c) review and approval of Company policies and procedures regarding management of financial accounts, execution of legal documents, applicable ethical rules and ethical practices and other important matters;

(d) decisions on the appointment, compensation, discipline and dismissal of the Management Personnel;

(e) the establishment of Company bank accounts and the appointment of the Company's Independent Auditor;

(f) the establishment of bank credit facilities or the borrowing of loans having an aggregate value in excess of RMB 10,000,000 or its equivalent in USD in a single transaction or a series of related transactions;

(g) the purchase of capital equipment, land and buildings or other assets having an aggregate value in excess of RMB 2,000,000 or its equivalent in USD in a single transaction or a series of related transactions other than such purchases made in accordance with

the operating budget approved by the Board and (as appropriate) the Shareholders Meeting;

(h) any expenditure in excess of, or any transaction that materially deviates from the approved annual budget or financial plan, and any amendment to the annual budget or financial plan;

(i) the granting of loans or credit to any third parties in any amount (other than the sale of the Company's products or services to customers on standard deferred payment terms or the granting of purchase credits to customers in the ordinary course of business);

(j) the giving of any financial guarantee by the Company for the obligations of any third party;

(k) the execution of technology licence agreements with third parties other than in the ordinary course of business on customary terms and conditions;

(l) the establishment of branch offices and liaison offices;

(m) any other matter which, in accordance with the provisions of this Agreement or under Applicable Law, requires Board approval or which the Board determines shall require Board approval.

7.4 If a Board Deadlock Matter arises, one or more Directors nominated by a Party may, within twenty Business Days after the Board meeting at which the Board Deadlock Matter arose, cause its nominated Directors to submit a Deadlock Notice in the agreed form to the Chairman and all other Directors. Within five Business Days after submission of the Deadlock Notice, the Chairman shall refer such Board Deadlock Matter to the Senior Representatives of the Parties, who shall use all reasonable endeavours in good faith to resolve such Board Deadlock Matter within twenty Business Days from the date of such referral. Any resolution of such Board Deadlock Matter agreed to by the Senior Representatives of the Parties shall be final and binding on the Company and the Parties. If the Board Deadlock Matter is not resolved by the Senior Representatives of the Parties, then a Party shall have the right to submit a Termination Notice in accordance with the provisions of Paragraph 12. No Board Deadlock Matter may be referred by a Party for determination by arbitration pursuant Paragraph 20.

8. *Supervisors*

8.1 The Company shall have two Supervisors: one Supervisor nominated by People's and one Supervisor nominated by American, elected by the

Shareholders Meeting. The term of office of a Supervisor shall be three years.

8.2 The Supervisors exercise the following functions and duties:

(a) examining the Company's financial affairs;

(b) supervising the Directors and Management Personnel in the performance of their duties and to propose the removal of Directors or Management Personnel who violate laws, administrative regulations, the Articles of Association or resolutions of the Board;

(c) requiring Directors or Management Personnel to rectify their acts which are detrimental to the Company's interests;

(d) submitting proposals to the Parties;

(e) upon request of the Parties, instituting legal proceedings against Directors or Management Personnel who have violated laws, administrative regulations or the Articles of Association and have thereby caused the Company to incur a loss; and

(f) other functions and powers as provided under Applicable Law and the Articles of Association.

In addition, a Supervisor may attend meetings of the Board of Directors as a non-voting attendee and raise questions or present proposals on matters relating to Board resolutions.

9. *Manangement*

The Company shall have a General Manager and a CFO nominated by American. Each Party shall cause each of the Directors nominated by it to exercise all of their Voting Rights at any regular or interim Board meeting to appoint the Management Personnel as nominated in accordance with the provisions of this Paragraph 9. The General Manager shall be responsible for all of the day-to-day operations and management of the Company other than matters reserved for decision by the Shareholders Meeting or the Board. He shall be responsible to the Board and shall carry out all matters as directed by the Board.

10. *Financial Affairs and Accounting*

10.1 The Company shall at all times maintain accurate and complete accounting and other financial records, and shall prepare all accounts and financial statements in accordance with Chinese Accounting Standards (Accounting Standards for Business Enterprises – Basic Standards). The Company shall adopt Renminbi as its bookkeeping base currency, but may also adopt USD or other foreign currencies as supplementary bookkeeping currencies. The Company's fiscal year shall begin on January 1 and end on December 31 of each year, except that the first fiscal year of the Company shall commence on the Business Licence Issuance Date and shall end on December 31 of the same year, and the

last fiscal year shall commence on January 1 and end on the termination date in the same year.

10.2 The Company shall provide to each of the Parties: (a) annual financial reports no later than ninety calendar days after the end of each fiscal year; and (b) quarterly financial reports no later than forty-five days after the end of each fiscal quarter. Each Party (so long as it holds 10% or more of the Registered Capital of the Company) shall have the right, at its own expense, to appoint either the internal staff of such Party or an independent accountant to audit the books, accounts and other financial, commercial and legal records of the Company on behalf of such Party.

10.3 Subject to the requirements of Applicable Law, and unless otherwise determined by the Shareholders Meeting by Simple Majority Shareholders Resolution for any particular fiscal year, the Parties shall cause that the Company shall distribute dividends to the Parties. Each Party shall exercise all of its Voting Rights to approve distribution by way of dividend of all of the Distributable Profits of the Company for each fiscal year. Dividends shall be distributed to the Parties in proportion to their respective percentage shares of the Registered Capital.

11. *Non-Competition*

Unless it has obtained the prior written consent from the other Party, a Party must not, either alone or jointly, with, through or on behalf of any person, directly or indirectly: (a) carry on or be engaged or concerned or interested in any Competing Business in the Territory; (b) do business with any person who is, or has been, a customer of the Company at any time during the term of this Agreement; or (c) solicit any employee, officer or manager of the Company or any person who has been an employee, officer or manager of the Company within the previous two-year period. Each Party agrees to procure that each of its Affiliates shall comply with the provisions of this Paragraph 11 as though it applied directly to the Affiliate. This Paragraph 11 shall continue to apply to each Party and each of its Affiliates for a period of twenty-four months from the date on which such Party ceases to hold any Equity Interests of the Company.

12. *Term and Termination*

12.1 This Agreement shall take effect on the Effective Date and shall continue in force for a term of ten years (the "Term") unless extended pursuant to Paragraph 12.2 or earlier terminated pursuant to Paragraph 12.3.

12.2 Unless a Party notifies the other Party of its decision not to renew this Agreement through written notice signed by its authorised representative and delivered to the other Party at least ninety calendar days prior to the scheduled expiry of the Term, then the Term shall automatically renew for an additional term of five years from the scheduled expiry of the Term and each Party shall exercise all of its

Voting Rights to approve the extension of the Term and to cause the Company to register such extension with the State Administration for Market Regulation.

12.3 This Agreement shall terminate upon expiry of the Term, upon the written agreement of the Parties, if a Party acquires 100% of the Equity Interests and all registration formalities in respect thereof have been completed; or if an order is made, or a resolution is duly passed, to dissolve, wind up or liquidate the Company.

12.4 A Party (the "Notifying Party") shall have the right to submit a Termination Notice to the other Party to terminate this Agreement if:

(a) the other Party commits a Material Breach, and the Cure Period (if any) in respect thereof has expired;

(b) the other Party undergoes a Change of Control;

(c) the other Party experiences an Insolvency Event;

(d) a Board Deadlock Matter or Shareholder Deadlock Matter arises and cannot be resolved in accordance with the provisions of Paragraph 5.4 or Paragraph 7.4;

(e) the conditions or consequences of Force Majeure have a Material Adverse Effect on the business, assets or operations of the Company and continue for a period in excess of six months; or

(f) a Material Modification is made at any time by any government authority to this Agreement, the Articles of Association, the Business Licence, any Additional Permit or any Ancillary Agreement;

provided that no Party may submit a Termination Notice in respect of any event under this Paragraph 12.4 more than sixty calendar days after the day the Notifying Party first knew or should have known of the occurrence of the event(s) giving rise to the Termination Notice. In respect of a Termination Notice delivered pursuant to Paragraph 12.4(a)-(c), the provisions under Paragraph 13 shall apply. In respect of a Termination Notice delivered pursuant to Paragraph 12.4(d)-(f), the provisions under Paragraph 14 shall apply.

13. *Mandatory Transfer Event Option*

If the Notifying Party has submitted a valid Termination Notice pursuant to Paragraph 12.4(a)-(c), then the Notifying Party shall have the right either to purchase all of the Equity Interests in the Company held by the other Party (the "Mandatory Offeror") or to cause the Mandatory Offeror to purchase all of the Equity Interests in the Company held by the Notifying Party. The Parties shall determine the Fair Market Value of the Designated Equity Interests in accordance with Paragraph 15. Within ten Business Days following the date of determination of the Fair Market Value of the Designated Equity Interests, the Notifying Party shall have the right to submit to the Mandatory Offeror an unconditional and irrevocable Mandatory

Transfer Notice in the agreed form confirming that it will purchase from the Mandatory Offeror (or sell to the Mandatory Offeror, as the case may be) all of the Designated Equity Interests at the Reference Price. If the Notifying Party submits a Mandatory Transfer Notice, then completion of the Transfer of the Designated Equity Interests shall occur at such time and place as designated in accordance with the terms of the relevant Mandatory Transfer Notice. If the Notifying Party fails to submit a Mandatory Transfer Notice, then it shall be deemed to have opted out of the provisions of this Paragraph 13, in which case the provisions of Paragraph 16 shall apply.

14. *Mutual Buy-Out*

If the Notifying Party has submitted a valid Termination Notice pursuant to Paragraph 12.4(d)-(f), then the Parties shall initiate the buy-out procedures set out in this Paragraph 14. The Parties shall determine the Fair Market Value of the Company in accordance with Paragraph 15. Within ten Business Days following the date of determination of the Fair Market Value of the Company, each Party shall have the right to submit to the other Party an Indication of Interest to purchase all (but not less than all) of the Equity Interests of the other Party at the applicable Reference Price. If neither Party submits an Indication of Interest to the other Party, then the Parties shall be deemed to have opted out the provisions of this Paragraph 14, in which case the provisions of Paragraph 16 shall apply. If only one Party ("Sole Submitting Party") submits an Indication of Interest, then such Indication of Interest shall be deemed to be an unconditional and irrevocable offer by the Sole Submitting Party to purchase all of the Equity Interests of the other Party at the applicable Reference Price, which shall be binding on both Parties. If both Parties submit an Indication of Interest, each Party shall submit a sealed bid setting out an unconditional and irrevocable offer to purchase all (but not less than all) of the Equity Interests of the other Party at a purchase price which shall be not less than the applicable Reference Price (the "Offer Price"). The Party offering the higher Offer Price shall be the winning bidder.

15. *Valuation*

The Parties shall conduct negotiations on the valuation of the Company for a period of thirty days from the date of submission of the Termination Notice. If the Parties are able to agree on the valuation of the Company, that agreed amount shall be the Fair Market Value for purposes of this Agreement. If the Parties are unable to agree on the valuation of the Company by the end of such thirty-day period, the Parties shall jointly select and appoint a reputable independent valuation firm registered in China (a "Qualified Valuation Firm") to conduct a valuation of the Company. The Qualified Valuation Firm(s) shall value the Company on a going concern basis using the Industry Valuation Method subject to and in accordance with the requirements of Applicable Law. The "Reference Price" for the Designated Equity

Interests shall be the Fair Market Value of the Company as determined in accordance with this Paragraph 15 multiplied by the percentage of the Registered Capital of the Company represented by the Designated Equity Interests at the time of valuation.

16. *Dissolution of Company*

16.1 Voluntary dissolution of the Company shall be undertaken pursuant to a duly passed Supermajority Shareholders Resolution upon the agreement of the Parties, upon the expiry of the Term, if the Parties are deemed to have opted out of Paragraph 13, or if the Parties are deemed to have opted out of Paragraph 14.

16.2 Involuntary dissolution of the Company shall be undertaken pursuant to an order for dissolution of the Company issued by the relevant government authority and in accordance with the requirements of Applicable Law.

16.3 Within fifteen Business Days following either the date on which (a) the Supermajority Shareholders Resolution for dissolution of the Company was approved; or (b) the order for involuntary dissolution was issued by the relevant government authority, the Parties shall appoint a liquidation committee which shall have the power to represent the Company in all legal matters. Each of the parties shall appoint one member of the liquidation committee. Following such appointment of the liquidation committee, a dissolution application shall be registered with the AMR. The liquidation committee shall appoint a Qualified Valuation Firm to conduct a valuation of the Company's assets on a current fair market value basis subject to and in compliance with Applicable Law. The liquidation committee shall be authorised to undertake the following steps as appropriate in connection with the winding up of the Company: (a) continue the operation of the Business solely as necessary for purposes of winding up the affairs of the Company; (b) perform contracts and collect, pay, compromise and settle debts and claims for or against the Company; (c) dispose of all or any part of the assets of the Company for cash in such amounts as the liquidation committee shall consider reasonable and appropriate; (d) enter into agreements and take all such other steps in the name of the Company as the liquidation committee may deem necessary or appropriate in order to wind up the affairs of the Company; and (e) employ agents, attorneys and other professional consultants and advisors assist with the liquidation and winding up of the affairs of the Company.

17. *Confidentiality*

From time to time prior to and during the Term the Company or a Party ("Disclosing Party") has disclosed or may disclose Confidential Information to the other Party ("Receiving Party"). The Receiving Party shall, during the Term and for 5 years thereafter maintain the confidentiality of Confidential Information and not use Confidential

Information for any purposes other than those specifically set out in this Agreement.

18. *Breach of Agreement*

Upon the occurrence of a Material Breach or any other breach of contract, then in addition to its other rights under this Agreement, the Non-breaching Party may give written notice of breach in the agreed form to the Breaching Party describing the nature and scope of the breach and demanding that the Breaching Party cure the breach at its cost within ninety calendar days ("Cure Period"). If the Breaching Party fails to cure the breach within the Cure Period, then in addition to its other rights hereunder or under Applicable Law, the Non-breaching Party may claim direct and foreseeable damages arising from the breach.

19. *Force Majeure*

Force Majeure means all events which are beyond the control of the Parties to this Agreement, and which are unforeseen, unavoidable or insurmountable, and which prevent total or partial performance by either Party. A Party's contractual obligations affected by an event of Force Majeure under this Agreement shall be suspended during the period of delay caused by the Force Majeure and shall be automatically extended, without penalty or liability, for a period equal to such suspension. The Party claiming Force Majeure shall promptly inform the other Party in writing and shall furnish within ten Business Days thereafter sufficient proof of the occurrence and duration of such Force Majeure. The Parties shall immediately consult with each other in order to find an equitable solution and the Party claiming Force Majeure shall use its best endeavours to minimise the consequences of such Force Majeure.

20. *Settlement of Disputes*

20.1 In the event of any dispute, controversy or claim arising out of or relating to this Agreement, or the breach, termination or invalidity hereof ("Dispute"), the Parties shall attempt in the first instance to resolve such Dispute through friendly consultations.

20.2 In the event such dispute is not resolved through consultations within sixty days after the date such consultations were first requested in writing by a Party, then any Party may submit the dispute for arbitration administered by the Tianjin International Economic and Financial Center of the China International Economic and Trade Arbitration Commission (CIETAC) for arbitration in Tianjin in accordance with the CIETAC's arbitration rules in effect when the notice of arbitration is submitted. The number of arbitrators shall be three. The arbitral award is final and binding on both Parties.

20.3 Notwithstanding the foregoing, the Parties agree that each Party has the right to seek for specific performance, injunctions or other similar relief as permitted under Applicable Law in any court of

competent jurisdiction for any claims of breach of confidentiality or intellectual property rights infringement.

21. *Applicable Law*

This Agreement is governed by and will be construed in accordance with the laws of the People's Republic of China.

22. *Language*

This Agreement is executed in both the Chinese language and the English Language. Both language versions shall be equally valid.

IN WITNESS WHEREOF, each of the Parties hereto has caused this Agreement to be executed by its duly authorised representative on the date first set forth above in Tianjin, People's Republic of China.

____________________________________

on behalf of American Hair Products, Inc.

____________________________________

on behalf of People's Manufacturing Corporation

## QUESTIONS

**(1)** Review the matters subject to decision by the Shareholders Meeting and the Board of Directors set forth in Paragraphs 5 and 7 and the functions of the supervisors in Paragraph 8. What seem to be the principal responsibilities of each?

**(2)** In-kind contributions to registered capital must be valued by a Chinese appraisal organization and approved by the relevant government authorities. If these valuations differ from those of the parties, it may affect the parties' respective contributions to registered capital and thus their rights to share in the profits of the joint venture. Does the contract adequately provide for this possibility?

**(3)** If American Hair Products is concerned about its ability to control the day-to-day operations of the joint venture, which of the following should be most important to it: (a) its voting rights at the shareholders meetings; (b) the ability to elect a majority of the joint venture's directors; (c) the ability to appoint the chair of the board; or (d) the ability to appoint the joint venture's general manager?

**(4)** In what ways does the Joint Venture Agreement protect the interests of the minority partner? Do those protections seem adequate? Do they seem excessive?

**(5)** If American becomes disenchanted with its partner's performance, what options would it have under the Joint Venture Agreement?

**Additional reading:** Prescott & Swartz, Joint Ventures in the International Arena (2d ed. 2010); Wolf, The Complete Guide to

International Joint Ventures with Sample Clauses and Contracts (3d ed. 2011).

## C. CHINESE REGULATION OF FOREIGN INVESTMENT

In 2019, the National People's Congress adopted the Foreign Investment Law of the People's Republic of China (FIL) to unify the treatment of foreign investment in China. Prior to adoption of the FIL, China had separate laws governing equity joint ventures, contractual joint ventures, and wholly foreign-owned enterprises. Article 42 of the FIL repeals these laws effective January 1, 2020. Existing companies organized under those laws have five years to transition to the new law.

Many foreign investors have thought it useful to have a Chinese partner with existing manufacturing facilities, access to local supply chains and distribution networks, and familiarity with the local bureaucracy. Foreign investors wishing to establish joint ventures may form limited liability companies under the Company Law of the People's Republic of China, like the one in the sample joint venture agreement above. In general, limited liability companies have greater flexibility than equity joint ventures did under the prior law. The highest authority of a limited liability company is the shareholders meeting rather than the board of directions. The Company Law requires two-thirds shareholder approval of certain decisions, see Joint Venture Agreement 5.2 supra, but this compares favorably with the requirement of unanimous board approval under the prior law.

Under the FIL, foreign investment is permitted in any industry except those specified in the Special Administrative Measures for the Access of Foreign Investment—the so-called "Negative List." The current version of the Negative List dates to 2020 and includes 33 limitations in 12 economic sectors. The FIL also does away with the requirement that foreign investments be approved by the Ministry of Commerce (MOFCOM), which Chinese parties had sometimes exploited to back out of joint ventures at the last moment. Under the new law, a joint venture agreement becomes effective when the parties say it is effective, and it need only be registered with the State Administration for Market Regulation (SAMR). Finally, the FIL provides specific protections with respect to expropriation, the transfer of profits, and the protection of intellectual property rights.

### Foreign Investment Law[3]

Adopted March 15, 2019
Effective January 1, 2020

### Chapter I. General Provisions

[3] http://mg2.mofcom.gov.cn/article/policy/China/201909/20190902898870.shtml

**Article 1.** The Foreign Investment Law of the People's Republic of China (hereinafter referred to as "the Law") is hereby formulated in accordance with the Constitution of the People's Republic of China in a bid to further expand opening-up, vigorously promote foreign investment, protect the legitimate rights and interests of foreign investors, standardize the management of foreign investment, impel the formation of a new pattern of all-round opening-up and boost the sound development of the socialist market economy.

**Article 2.** The Law shall be applicable to the foreign investment within the territory of the People's Republic of China ("the territory of China").

For the purpose of the Law, foreign investment refers to the investment activity directly or indirectly conducted by a foreign natural person, enterprise or other organization (the "foreign investors"), including the following circumstances:

1. A foreign investor establishes a foreign-funded enterprise within the territory of China, independently or jointly with any other investor;

2. A foreign investor acquires shares, equities, property shares or any other similar rights and interests of an enterprise within the territory of China;

3. A foreign investor makes investment to initiate a new project within the territory of China, independently or jointly with any other investor; and

4. A foreign investor makes investment in any other way stipulated by laws, administrative regulations or provisions of the State Council.

For the purpose of the Law, a foreign-funded enterprise refers to an enterprise that is incorporated under the Chinese laws within the territory of China and is wholly or partly invested by a foreign investor.

**Article 3.** The State shall adhere to the basic state policy of opening-up and encourage foreign investors to make investments within the territory of China.

The State shall implement policies on high-level investment liberalization and convenience, establish and improve the mechanism to promote foreign investment, and create a stable, transparent, foreseeable and level-playing market environment.

**Article 4.** The State shall implement the management systems of pre-establishment national treatment and negative list for foreign investment.

For the purpose of the preceding paragraph, pre-establishment national treatment refers to the treatment given to foreign investors and their investments during the investment access stage, which is not lower than that given to their domestic counterparts; negative list refers to

special administrative measures for the access of foreign investment in specific fields as stipulated by the State. The State shall give national treatment to foreign investment beyond the negative list.

The negative list will be issued by or upon approval by the State Council.

If more preferential treatment concerning access is offered to a foreign investor under any international treaty or agreement that the People's Republic of China concludes or joins in, relevant provisions in such treaty or agreement may prevail.

**Article 5.** The State shall protect foreign investors' investment, earnings and other legitimate rights and interests within the territory of China in accordance with the law.

**Article 6.** Foreign investors and foreign-funded enterprises carrying out investment activities within the territory of China shall observe the Chinese laws and regulations, and shall not impair China's security or damage any public interest.

**Article 7.** The competent departments for commerce and investment under the State Council shall, pursuant to the division of duties, promote, protect and manage foreign investment; other relevant departments under the State Council shall take charge of the relevant work in the promotion, protection and management of foreign investment within the scope of their respective duties.

The relevant department under the local people's government at or above the county level shall carry out the work relating to promotion, protection and management of foreign investment in accordance with laws and regulations and in line with the division of duties determined by the people's government at the same level.

**Article 8.** Employees of a foreign-funded enterprise shall, pursuant to the law, establish trade union, carry out trade union activities, and safeguard their legitimate rights and interests. A foreign-funded enterprise shall provide necessary conditions for its trade union to carry out relevant activities.

* * *

### Chapter III. Investment Protection

**Article 20.** The State is not to expropriate any investment made by foreign investors.

Under special circumstances, the State may expropriate or requisition an investment made by foreign investors for public interests in accordance with the law. Such expropriation or requisition shall be made pursuant to statutory procedures and fair and reasonable compensation will be given in a timely manner.

**Article 21.** A foreign investor may, in accordance with the law, freely transfer inward and outward its contributions, profits, capital

gains, income from asset disposal, royalties of intellectual property rights, lawfully obtained compensation or indemnity, income from liquidation and so on within the territory of China in CNY or a foreign currency.

**Article 22.** The State shall protect the intellectual property rights of foreign investors and foreign-funded enterprises, and protect the legitimate rights and interests of holders of intellectual property rights and relevant right holders; in case of any infringement of intellectual property right, legal liability shall be investigated strictly in accordance with the law.

During the process of foreign investment, the State shall encourage technology cooperation on the basis of free will and business rules. Conditions for technology cooperation shall be determined by all investment parties upon negotiation under the principle of equity. No administrative department or its staff member shall force any transfer of technology by administrative means.

**Article 23.** Administrative departments and their staff members shall keep confidential any trade secret of foreign investor or foreign-funded enterprise they are aware of during the performance of their duties, and shall not divulge or illegally provide to others the secret.

* * *

### Chapter IV. Investment Management

**Article 28.** Foreign investors shall not invest in any field forbidden by the negative list for access of foreign investment (hereinafter referred to as the "negative list").

For any field restricted by the negative list, foreign investors shall conform to the investment conditions provided in the negative list.

Fields not included in the negative list shall be managed under the principle that domestic investment and foreign investment shall be treated uniformly.

**Article 29.** During the process of foreign investment, where verification and record-filing of a foreign investment project are required, relevant provisions of the State shall be followed.

**Article 30.** If a foreign investor invests in an industry or field where license is required in accordance with the law, relevant licensing formalities shall be handled as stipulated by law.

Unless otherwise provided by laws or administrative regulations, relevant competent department shall review the application for license filed by the foreign investor based on the same conditions and procedures as those for domestic investment.

**Article 31.** The organization form, institutional framework and standard of conduct of a foreign-funded enterprise shall be subject to the provisions of the Company Law of the People's Republic of China, the

Partnership Enterprise Law of the People's Republic of China, and other laws.

**Article 32.** In carrying out production and operation activities, foreign-funded enterprises shall conform to relevant provisions on labor protection and social insurance stipulated in laws and administrative regulations, handle tax, accounting, foreign exchange and other matters in accordance with laws, administrative regulations and relevant provisions of the State, and shall be subject to the supervision and inspection conducted by relevant competent departments in accordance with the law.

**Article 33.** Foreign investors who acquire a company within the territory of China through mergers and acquisitions or participate in the concentration of undertakings by other means shall be subject to the examination for concentration of undertakings as stipulated by the Anti-Monopoly Law of the People's Republic of China.

**Article 34.** The State shall establish a foreign investment information reporting system. Foreign investors or foreign-funded enterprises shall submit the investment information to competent departments for commerce through the enterprise registration system and the enterprise credit information publicity system.

The contents and scope of foreign investment information to be reported shall be determined under the principle of necessity; investment information that is available through interdepartmental information sharing will not be required to be submitted again.

**Article 35.** The State shall establish a security review system for foreign investment, under which the security review shall be conducted for any foreign investment affecting or having the possibility to affect national security.

The decision made upon the security review in accordance with the law shall be final.

* * *

### Chapter VI. Supplementary Provisions

* * *

**Article 42.** The Law shall come into effect as of January 1, 2020. The Law of the People's Republic of China on Sino-Foreign Equity Joint Ventures, the Law of the People's Republic of China on Wholly Foreign-owned Enterprises and the Law of the People's Republic of China on Sino-Foreign Cooperative Joint Ventures shall be repealed simultaneously.

Foreign-funded enterprises, which were established in accordance with the Law of the People's Republic of China on Sino-Foreign Equity Joint Ventures, the Law of the People's Republic of China on Wholly Foreign-owned Enterprises and the Law of the People's Republic of China on Sino-Foreign Cooperative Joint Ventures before the implementation of the Law, may retain their original organization forms and other

aspects for five years upon the implementation hereof. Specific implementation measures shall be formulated by the State Council.

**Additional reading:** Chow, The Legal System of the People's Republic of China in a Nutshell (3d ed. 2015); Zimmerman, China Law Deskbook (4th ed. 2014); Cao, Corporate Income Tax Law and Practice in the People's Republic of China (2011); China Law Blog, www.chinalaw blog.com.

## D. RESOLVING DIFFERENCES

Differences will inevitably arise during the life of a joint venture. It may be possible to anticipate areas in which tensions are likely and to draft the joint venture contract to deal with some of them. At a minimum, the parties will need to give careful thought to the dispute resolution provisions of their agreement.

### 1. TENSIONS IN THE JOINT VENTURE RELATIONSHIP

Although the partners to a joint venture will obviously have some interests in common, they will just as obviously have some that are not. The Chinese saying "same bed, different dreams" (同床异梦) nicely captures the situation in which joint venture partners may find themselves. One can predict in a general way how differences and tensions are going to develop over the life of a joint venture:

**Technology**

Characteristically the local partner will want the most advanced technology for the joint venture. The foreign partner, on the other hand, may be content to use technology that might be regarded as outmoded back home but seems adequate for local circumstances. The foreign partner may wish to place restrictions on the use of its technology to safeguard its intellectual property rights. The local partner may resist these restrictions or simply ignore them, using the technology to improve its own products, which then compete with the joint venture's. The local partner may also come to resent the continuing payment of royalties to the foreign partner once the technology has been learned and has come to seem obvious. There is also the question of who owns improvements made by the joint venture; the local partner will tend to see these as the property of the joint venture, while the foreign partner will tend to see them as part of its own technology.

**Procurement**

Each joint venture partner may have preferences about the firms from which goods and services are purchased. In many less developed countries there is a tendency for companies to make purchases from related or "friendly" firms, which the foreign partner may view with suspicion. On the other hand, if the joint venture purchases materials from the foreign partner, the foreign partner may resist any attempt by

the joint venture to redirect those purchases even if other sources of supply become cheaper.

**Personnel**

The foreign partner will be skeptical of the presence of family members and friends in the management of the joint venture, something that may seem quite natural to the local partner. (Whom can one trust if not one's cousin?) The foreign partner may also be troubled to find that the local personnel it has trained are often transferred to the local partner's own operation. The local partner, on the other hand, may resent the rotation of managers from the foreign partner, who bring with them a certain arrogance and seem to leave just when they have started to understand something about local conditions.

**Expansion**

The local partner—sometimes under local government pressure—may wish to export to foreign markets. This may trouble the foreign partner, which may be supplying those markets either through its own manufacturing or through licensees. The roles may be reversed as to local markets, with the foreign partner wishing to expand into other product lines and the local partner being constrained by ties of family, school, or guild from entering into competition with other local firms. Expansion may also require additional infusions of capital, which the local partner may have more difficulty providing.

**Dividends and Investment Policy**

In the typical case, the local partner will want a higher percentage of the joint venture's profits paid out as dividends while the foreign partner may prefer to reinvest the profits in the joint venture. The greater size of the foreign partner may give it a longer profit horizon, and it may see advantages in deferring the payment of its home country's taxes (although recent changes to U.S. tax law have largely removed these advantages, see supra p. 315). The local partner may feel pressure from its government to show a return more quickly. On the other hand, in a country with considerable political tensions the roles may reverse. The foreign partner will see opportunities at home or in third countries that promise as good a rate of return with less risk, while the local partner will be under pressure from the government not to let funds go abroad and will be inured to local risks.

**Compliance with Law**

The foreign partner may think that complying with all legal requirements in the host country will take too long or be too expensive. It may believe that the local partner's relationship with certain government officials will provide sufficient protection. The local partner may sometimes encourage the foreign partner in this belief. Government officials, however, may be promoted, transferred, or even prosecuted for corruption. Moreover, illegality in some aspect of a joint venture may be

exploited by the local party or by the local government to gain further concessions from the foreign party.

**Culture**

Managers from different companies and from different countries often have different ways of doing things. Cultural differences may be magnified in a relationship in which one party is expected to provide the technology and management expertise. There is a tendency for foreign managers to view their local partners as lazy and resistant to change and for local managers to view their foreign counterparts as arrogant and condescending. Such attitudes can obviously create friction in day-to-day working relationships.

---

The unraveling of the Danone-Wahaha joint venture between 2007 and 2009 illustrates a number of problems that joint ventures may encounter in the People's Republic of China. Founded in 1996, this joint venture grew to be China's largest bottled water and beverage company, with 15% of the Chinese market. Once considered a joint-venture showcase, it now stands as a prime example of mistakes to be avoided.

The Chinese partner in the joint venture was Hangzhou Wahaha Group, originally a state-owned enterprise owned by the Hangzhou city government. Hangzhou Wahaha Group's founder Zong Qinghou built the Wahaha trademark into a valuable brand by selling nutritional drinks for children. (In Chinese, "Wahaha" sounds like a baby laughing.) The foreign joint venture partners were the French company Danone Group and a Hong Kong corporation, Bai Fu Qin. Danone and Bai Fu Qin did not invest in the joint venture directly but rather through a Singapore corporation, Jin Jia Investment. Hangzhou Wahaha Group's sole contribution to the joint venture was the Wahaha trademark, valued at US$13.2 million, while Jin Jia contributed US$66.1 million in cash.

Some of the joint venture's problems grew from issues regarding control. At the outset, Hangzhou Wahaha Group owned 49% of the joint venture's shares and Jin Jia owned 51%. Danone and Bai Fu Qin each owned 50% of Jin Jia and thus each owned 25.5% of the joint venture. Although the Chinese partner owned less than 50% of the joint venture's shares, it saw itself as the majority partner. But in 1998 Danone bought out Bai Fu Qin, becoming the 51% owner of the joint venture and causing resentment on the part of its Chinese partner.

Changing the ownership structure, however, did not change control of the joint venture on the ground. From the start, the joint venture was managed entirely by Hangzhou Wahaha Group and its chairman Zong. Danone's prior lack of success in the Chinese market may have led it to take a hands-off approach, but as a result the joint venture's management and employees developed loyalties to the Chinese joint venture partner and Zong. As events would show, Danone lacked even a basic ability to monitor the joint venture's activities.

Other problems arose from the failure to follow legal formalities. In 1996 China's Trademark Office rejected transfer of the Wahaha trademark from the Chinese partner to the joint venture on the ground that the trademark belonged to state, although Hangzhou Wahaha Group had become a private company after formation of the joint venture. Rather than appeal this decision, the parties decided to work around it by entering an exclusive license agreement for the trademark in 1999. The full license agreement was to run for 50 years, but to obtain government approval the parties registered only an abbreviated version, representing the agreement as a non-exclusive 10-year license. This put Danone in a weak position to enforce its rights if problems arose.

Both the trademark license agreement and the joint venture agreement prohibited Hangzhou Wahaha Group from using the Wahaha trademark and from competing with the joint venture. But beginning in 2000, Zong created a series of companies, owned partly by Hangzhou Wahaha Group and partly by members of his family, which sold the same products as the joint venture using the Wahaha trademark. Because of its hands-off approach, Danone did not learn of the parallel companies until 2005.

After negotiations to integrate the parallel companies into the joint venture failed, Danone in 2007 began arbitration at the Stockholm Chamber of Commerce, as provided in the joint venture agreement. Hangzhou Wahaha Group and Zong responded to claims about competing with the joint venture by initiating suits in Chinese courts against three Danone-appointed directors alleging that their service as directors or managers of other competing Chinese companies violated China's Company Law. Hangzhou Wahaha Group also successfully challenged the validity of the trademark license agreement before a tribunal of the Hangzhou Arbitration Commission, a decision upheld by the Hangzhou Intermediate People's Court.

In September 2009, the Stockholm Chamber of Commerce tribunal ruled for Danone. On the same day, the parties announced that they had reached a settlement under which Zong agreed to buy Danone's 51% interest in the joint venture for US$450 million.[4] Combined with a reported US$380 million in dividends over the life of the joint venture, Danone made a substantial profit on its initial investment. But it ultimately lost control to its Chinese partner of a very profitable investment—one that near the end accounted for more than 5% of Danone's profits worldwide.

[4] Mitchell & Dyer, French Food Group's Chinese Venture Leaves a Bitter Taste, Financial Times (Nov. 10, 2009).

**QUESTIONS**

**(1)** Consider the Joint Venture Contract between American Hair Products and People's Manufacturing Corporation, supra. Do tensions seem likely to arise in any of the areas noted above?

**(2)** What might Danone have done differently to avoid the problems in its joint venture with Wahaha?

## 2. DISPUTE RESOLUTION IN U.S.-CHINESE JOINT VENTURES

When a joint venture agreement provides for the establishment of a company under Chinese law, it is natural that the agreement itself should also be governed by Chinese law. But the parties have numerous options for dispute resolution. U.S. parties are sometimes reluctant to choose Chinese courts because of doubts concerning those courts' independence from powerful local interests. Choosing U.S. courts was long thought to be unwise as well because of concerns about whether Chinese courts would enforce U.S. judgments against assets in China. Under Article 282 of the Civil Procedure Law of the People's Republic of China, Chinese courts enforce foreign judgments only "in accordance with an international treaty concluded or acceded to by the People's Republic of China or under the principle of reciprocity." There is no judgments treaty between China and the United States, and Chinese courts had been reluctant to find that U.S. courts reciprocally enforce Chinese judgments. But in 2017 a Chinese court in Wuhan enforced a U.S. judgment for breach of a share purchase agreement, and in 2018 a Chinese court in Shanghai enforced a U.S. judgment arising out of a joint venture agreement. Both courts found that U.S. practice enforcing Chinese judgments satisfied China's reciprocity requirement.[5] Whether this trend continues remains to be seen.

Parties who wish to settle their disputes through arbitration have a choice of arbitrating in China or abroad. Article 2 of the 1994 Arbitration Law of the People's Republic of China, as amended in 2017, provides: "Contractual disputes and other disputes over rights and interests in property between citizens, legal persons and other organizations that are equal subjects may be arbitrated." Article 65 extends this provision to arbitrations involving foreign elements.

You will have noted that the sample joint venture agreement above provides for arbitration before a Chinese arbitral body, the China International Economic and Trade Arbitration Commission (CIETAC). CIETAC is one of the busiest arbitration centers in the world, handling more than two thousand cases annually. CIETAC consists of an arbitration commission in Beijing and sub-commissions in Chongqing,

[5] See William S. Dodge & Wenliang Zhang, Reciprocity in China-U.S. Judgments Recognition, 53 Vand. J. Transnat'l L. 1541 (2020).

Fuzhou, Hangzhou, Shanghai, Shenzhen, Tianjin, and Wuhan. In 2012, CIETAC also established a branch office in Hong Kong, known as the CIETAC Hong Kong Arbitration Center. Under the CIETAC Rules, the parties may agree to have their arbitration administered by the commission in Beijing or by one of CIETAC's sub-commissions or centers. But where the parties do not agree or their agreement is ambiguous, the Beijing commission administers the arbitration. The introduction of this rule in 2012 led the Shanghai and Shenzhen sub-commissions to split from the Beijing commission. In 2015, the Supreme People's Court issued an interpretation on jurisdictional issues arising from the CIETAC split, deciding that arbitration agreements concluded before the split that refer to the Shanghai or Shenzhen sub-commissions may be heard by the breakaway sub-commissions and Chinese courts should enforce their awards.

CIETAC maintains a panel of more than 1,200 arbitrators, including more than 300 foreign arbitrators. Under the 2015 CIETAC Rules, arbitrators from outside this list may be appointed if the parties agree, subject to confirmation by the Chairman of CIETAC. CIETAC's mandatory fee schedule is low by international standards. While this makes CIETAC a lower-cost option for dispute resolution, it can also make it difficult to attract good foreign arbitrators.

The choice of CIETAC arbitration has several implications. First, CIETAC arbitration is obviously governed by the CIETAC arbitration rules, which may differ in certain respects from the arbitration rules of other institutions. Consider the following provisions from the 2015 CIETAC Rules:[6]

**Article 7.** Place of Arbitration

1. Where the parties have agreed on the place of arbitration, the parties' agreement shall prevail.

2. Where the parties have not agreed on the place of arbitration or their agreement is ambiguous, the place of arbitration shall be the domicile of CIETAC or its sub-commission/arbitration center administering the case. CIETAC may also determine the place of arbitration to be another location having regard to the circumstances of the case.

3. The arbitral award shall be deemed as having been made at the place of arbitration.

* * *

**Article 24.** Duties of Arbitrator

An arbitrator shall not represent either party, and shall be and remain independent of the parties and treat them equally.

[6] www.cietac.org/index.php?m=Page&a=index&id=106&l=en.

**Article 25.** Number of Arbitrators

1. The arbitral tribunal shall be composed of one or three arbitrators.

2. Unless otherwise agreed by the parties or provided by these Rules, the arbitral tribunal shall be composed of three arbitrators.

**Article 26.** Nomination or Appointment of Arbitrator

1. CIETAC maintains a Panel of Arbitrators which uniformly applies to itself and all its sub-commissions/arbitration centers. The parties shall nominate arbitrators from the Panel of Arbitrators provided by CIETAC.

2. Where the parties have agreed to nominate arbitrators from outside CIETAC's Panel of Arbitrators, an arbitrator so nominated by the parties or nominated according to the agreement of the parties may act as arbitrator subject to the confirmation by the Chairman of CIETAC.

**Article 27.** Three-Arbitrator Tribunal

1. Within fifteen (15) days from the date of receipt of the Notice of Arbitration, the Claimant and the Respondent shall each nominate, or entrust the Chairman of CIETAC to appoint, an arbitrator, failing which the arbitrator shall be appointed by the Chairman of CIETAC.

2. Within fifteen (15) days from the date of the Respondent's receipt of the Notice of Arbitration, the parties shall jointly nominate, or entrust the Chairman of CIETAC to appoint, the third arbitrator, who shall act as the presiding arbitrator.

3. The parties may each recommend one to five arbitrators as candidates for presiding arbitrator and shall each submit a list of recommended candidates within the time period specified in the preceding Paragraph 2. Where there is only one common candidate on the lists, such candidate shall be the presiding arbitrator jointly nominated by the parties. Where there is more than one common candidate on the lists, the Chairman of CIETAC shall choose the presiding arbitrator from among the common candidates having regard to the circumstances of the case, and he/she shall act as the presiding arbitrator jointly nominated by the parties. Where there is no common candidate on the lists, the presiding arbitrator shall be appointed by the Chairman of CIETAC.

4. Where the parties have failed to jointly nominate the presiding arbitrator according to the above provisions, the presiding arbitrator shall be appointed by the Chairman of the CIETAC.

* * *

**Article 31.** Disclosure

1. An arbitrator nominated by the parties or appointed by the Chairman of the CIETAC shall sign a Declaration and disclose any facts or circumstances likely to give rise to justifiable doubts as to his/her impartiality or independence.

2. If circumstances that need to be disclosed arise during the arbitral proceedings, the arbitrator shall promptly disclose such circumstances in writing.

3. The Declaration and/or the disclosure of the arbitrator shall be submitted to the Arbitration Court to be forwarded to the parties.

**Article 32.** Challenge to the Arbitrator

1. Upon receipt of the Declaration and/or the written disclosure of an arbitrator, a party wishing to challenge the arbitrator on the grounds of the disclosed facts or circumstances shall forward the challenge in writing within ten (10) days from the date of such receipt. If a party fails to file a challenge within the above time period, it may not subsequently challenge the arbitrator on the basis of the matters disclosed by the arbitrator.

2. A party having justifiable doubts as to the impartiality or independence of an arbitrator may challenge that arbitrator in writing and shall state the facts and reasons on which the challenge is based with supporting evidence.

3. A party may challenge an arbitrator in writing within fifteen (15) days from the date it receives the Notice of Formation of the Arbitral Tribunal. Where a party becomes aware of a reason for a challenge after such receipt, the party may challenge the arbitrator in writing within fifteen (15) days after such reason has become known to it, but no later than the conclusion of the last oral hearing.

4. The challenge by one party shall be promptly communicated to the other party, the arbitrator being challenged and the other members of the arbitral tribunal.

5. Where an arbitrator is challenged by one party and the other party agrees to the challenge, or the arbitrator being challenged voluntarily withdraws from his/her office, such arbitrator shall no longer be a member of the arbitral tribunal. However, in neither case shall it be implied that the reasons for the challenge are sustained.

6. In circumstances other than those specified in the preceding Paragraph 5, the Chairman of CIETAC shall make a final decision on the challenge with or without stating the reasons.

7. An arbitrator who has been challenged shall continue to serve on the arbitral tribunal until a decision on the challenge has been made by the Chairman of CIETAC.

* * *

**Article 51.** Scrutiny of Draft Award

The arbitral tribunal shall submit its draft award to CIETAC for scrutiny before signing the award. CIETAC may bring to the attention of the arbitral tribunal issues addressed in the award on the condition that the arbitral tribunal's independence in rendering the award is not affected.

* * *

**Article 81.** Language

1. Where the parties have agreed on the language of arbitration, their agreement shall prevail. In the absence of such agreement, the language of arbitration to be used in the proceedings shall be Chinese. CIETAC may also designate another language as the language of arbitration having regard to the circumstances of the case.

2. If a party or its representative(s) or witness(es) requires interpretation at an oral hearing, an interpreter may be provided either by the Arbitration Court or by the party.

3. The arbitral tribunal or the Arbitration Court may, if it considers it necessary, require the parties to submit a corresponding translation of their documents and evidence into Chinese or other languages.

---

Second, CIETAC's Rules provide that the arbitral tribunal may conciliate a dispute submitted to it if both parties agree. Conciliation ends and the arbitration proceedings resume when one of the parties so requests or the tribunal concludes that further efforts at conciliation would be futile. There has long been a preference in China for resolving disputes through mediation,[7] and today perhaps a third of CIETAC disputes are conciliated. Article 47(9) of the CIETAC rules provides: "Where conciliation is not successful, neither party may invoke any opinion, view or statement, and any proposal or proposition expressing acceptance or opposition by either party or by the arbitral tribunal in the process of conciliation as grounds for any claim, defense or counterclaim in the subsequent arbitral proceedings, judicial proceedings, or any other proceedings." Nevertheless, arbitrators may form opinions during the process of conciliation that may be difficult to put aside. Once the arbitrators have indicated their views during the course of conciliation, the parties may also feel pressure to settle so as not to anger the tribunal. To address this concern, the 2012 Rules added Article 47(8), which provides for conciliation outside the arbitral tribunal.

[7] See Cohen, Chinese Mediation on the Eve of Modernization, 54 Cal. L. Rev. 1201 (1966).

Third, the enforcement by Chinese courts of CIETAC awards is not governed by the New York Convention if such awards are made in China.[8] (The enforcement of CIETAC awards outside China in countries that are party to the New York Convention is governed by the Convention.) Articles 70 and 71 of the 1994 Arbitration Law of the People's Republic of China[9] require that a party resisting enforcement of a foreign-related arbitral award made in China, or applying to have such an award set aside, must show one of the circumstances set forth in Article 274 of the Civil Procedure Law of the People's Republic of China, as amended in 2012:

> **Article 274.** If a defendant provides evidence to prove that the arbitration award made by a foreign-affair arbitration institution of the People's Republic of China involves any of the following circumstances, the people's court shall, after examination and verification by a collegial bench, rule to disallow the enforcement of the award:
>
> (1) The parties have not stipulated any clause regarding arbitration in their contract or have not subsequently reached a written agreement on arbitration;
>
> (2) The defendant is not duly notified of the appointment of the arbitrators or the arbitration proceeding, or the defendant fails to express his defense due to the reasons for which he is not held responsible;
>
> (3) The formation of the arbitration panel or the arbitration procedure is not in conformity with rules of arbitration; or
>
> (4) The matters decided by arbitration exceed the scope of the arbitration agreement or the authority of the arbitration institution.
>
> If a people's court determines that the enforcement of an award will violate the social and public interest, the court shall make a ruling to disallow the enforcement of the arbitration award.[10]

As an alternative to CIETAC arbitration, the parties to a joint venture contract may choose a foreign arbitral body, such as the International Chamber of Commerce, the London Court of International Arbitration, the International Center for Dispute Resolution, the Stockholm Chamber of Commerce, or the Singapore International

---

[8] China made both reciprocity and commercial reservations upon acceding to the New York Convention in 1987.

[9] english.mofcom.gov.cn/aarticle/lawsdata/chineselaw/200411/20041100311032.html. The 2017 amendment did not change these provisions.

[10] This provision was originally Article 260 of the 1991 Civil Procedure Law, but was renumbered 258 when the law was amended in 2007, and was renumbered 274 when the law was again amended in 2012. The most recent amendment of the Civil Procedure Law in 2017 did not change this provision. For domestic awards, Article 237 of the Civil Procedure Law provides additional grounds for non-enforcement, including falsified or concealed evidence, corruption, and "twisting the law."

Arbitration Centre. Under Article 283 of the Civil Procedure Law, the enforcement in China of awards rendered by foreign arbitral bodies is governed by the New York Convention, and the grounds for refusing to enforce such awards are therefore limited to those stated in Article V of the Convention. See supra pp. 42–43. The Hong Kong International Arbitration Center is another alternative. Since Hong Kong reverted to Chinese sovereignty in 1997, the New York Convention has not applied to the enforcement of Hong Kong awards in China, but the 1999 Arrangement Concerning Mutual Enforcement of Arbitral Awards Between the Mainland and the Hong Kong Special Administrative Region reproduces the grounds for non-enforcement under the New York Convention almost word for word. China's Supreme People's Court has confirmed that this Arrangement also applies to awards by other arbitral institutions in Hong Kong and to ad hoc awards. The latter is particularly significant because, as a general matter, China does not permit or recognize ad hoc arbitrations.

Statistics on the enforcement of arbitral awards in China are difficult to come by. A 2016 survey of publicly reported cases by a law firm showed that foreign arbitral awards were enforced about 70% of the time, with enforcement rates improving in recent years.[11]

Although there is no appeal from a decision to enforce or refuse enforcement of an arbitral award, since 1995 the Supreme People's Court has attempted to increase enforcement by establishing a reporting system. Before refusing to enforce a foreign or foreign-related arbitral award, and before acting to set aside a foreign-related arbitral award, an Intermediate People's Court must submit a report to the High People's Court. If the High People's Court agrees that the award should not be enforced or should be set aside, it must submit a report to the Supreme People's Court. Only if the Supreme People's Court approves may the Intermediate People's Court refuse to enforce an award or set it aside. In 2018, a similar reporting system was extended to domestic arbitral awards. While this may provide additional protection in disputes between joint ventures and other Chinese companies (which are considered domestic), it may also increase the number of reported cases and slow down the reporting system.

## QUESTIONS

**(1)** Should any of the provisions in CIETAC's arbitration rules cause concern for a foreign joint venture partner? Could any of these concerns be ameliorated by changes to the arbitration clause?

**(2)** Compare the grounds for refusing to enforce an award in Article 274 of China's Civil Procedure Law to those in Article V of the New York

[11] Enforcing Foreign Arbitral Awards in China—A Review of the Past Twenty Years, http://www.kwm.com/en/knowledge/insights/enforcing-foreign-arbitral-awards-in-china-20160915.

Convention, supra pp. 42–43. Is there any reason to prefer one to the other?

**Additional reading:** Bosshart, Luedi & Wang, Past Lessons for China's New Joint Ventures, McKinsey Quarterly (Dec. 2010); Walsh, Wang & Xin, Same Bed, Different Dreams: Working Relationships in Sino-American Joint Ventures, 34 J. World Bus. 69 (1999); Miller, Glen, Jasperson & Karmokolias, International Joint Ventures in Developing Countries: Happy Marriages?, International Finance Corporation Discussion Paper Number 29 (1996). On the Danone-Wahaha joint venture, see Lee & Tan, Joint Ventures in China—Lessons to Be Learned from Danone v. Wahaha, in International Joint Ventures 543 (Campbell & Netzer eds., 2009). On dispute resolution in China, see Managing Business Disputes in Today's China: Duelling with Dragons (Moser ed., 2007); von Wunschheim, Enforcement of Commercial Arbitral Awards in China (2013); Judicial Independence in China: Lessons for Global Rule of Law Promotion (Peerenboom ed., 2010).

## E. ANTITRUST

Because joint ventures involve cooperation between potential competitors, they may raise concerns under antitrust or competition laws. Yet joint ventures do not always fit comfortably into the frameworks established for horizontal agreements, vertical agreements, and mergers. This Section considers the treatment of joint ventures under U.S. antitrust law, EU competition law, and China's Anti-Monopoly Law.

### 1. JOINT VENTURES UNDER U.S. ANTITRUST LAW

In United States v. Penn-Olin Chemical Co., 378 U.S. 158, 84 S.Ct. 1710, 12 L.Ed.2d 775 (1964), the U.S. Supreme Court stated:

> The joint venture, like the "merger" and the "conglomeration," often creates anticompetitive dangers. It is the chosen competitive instrument of two or more corporations previously acting independently and usually competitively with one another. The result is "a triumvirate of associated corporations." If the parent companies are in competition, or might compete absent the joint venture, it may be assumed that neither will compete with the progeny in its line of commerce. Inevitably, the operations of the joint venture will be frozen to those lines of commerce which will not bring it into competition with the parents, and the latter, by the same token will be foreclosed from the joint venture's market.
>
> This is not to say that the joint venture is controlled by the same criteria as the merger or conglomeration. The merger eliminates one of the participating corporations from the market

> while a joint venture creates a new competitive force therein. . . .
>
> Overall, the same considerations apply to joint ventures as to mergers, for in each instance we are but expounding a national policy enunciated by the Congress to preserve and promote a free competitive economy. . . .

The Penn-Olin case involved a domestic joint venture that was organized and owned by two major chemical concerns to produce sodium chlorate in the Southeastern United States. The Court found that, on the record before it, Section 1 of the Sherman Act had not been violated. However, it concluded that Section 7 of the Clayton Act applied to the joint formation and ownership of subsidiaries as well as to mergers with or acquisition of existing companies. The Court remanded the case for further proceedings and gave the following guidance:

> We note generally the following criteria which the trial court might take into account in assessing the probability of a substantial lessening of competition: the number and power of the competitors in the relevant market; the background of their growth; the power of the joint venturers; the relationship of their lines of commerce; the competition existing between them and the power of each in dealing with the competitors of the other; the setting in which the joint venture was created; the reasons and necessities for its existence; the joint venture's line of commerce and the relationship thereof to that of its parents; the adaptability of its line of commerce to non-competitive practices; the potential power of the joint venture in the relevant market; an appraisal of what the competition in the relevant market would have been if one of the joint venturers had entered it alone instead of through Penn-Olin; the effect, in the event of this occurrence, of the other joint venturer's potential competition; and such other factors as might indicate potential risk to competition in the relevant market. In weighing these factors the court should remember that the mandate of the Congress is in terms of the probability of a lessening of substantial competition, not in terms of tangible present restraint.

On remand, the district court held that, on the record before it, there was no reasonable probability that either parent corporation would have entered the Southeastern sodium chlorate market if Penn-Olin had not been organized. 246 F.Supp. 917 (D.Del.1965). This decision was affirmed by an equally divided Supreme Court, 389 U.S. 308, 88 S.Ct. 502, 19 L.Ed.2d 545 (1967). See also Texaco Inc. v. Dagher, 547 U.S. 1, 126 S.Ct. 1276, 164 L.Ed.2d 1 (2006) (holding that *per se* rule against horizontal price fixing did not apply to joint venturers who did not compete with each other in the relevant market).

Although Penn-Olin involved a domestic joint venture, other leading cases have dealt with various sorts of international joint ventures. Several of these have condemned joint ventures that were designed to divide markets among the joint venture partners. In Timken Roller Bearing Co. v. United States, 341 U.S. 593, 71 S.Ct. 971, 95 L.Ed. 1199 (1951), the Supreme Court upheld the District Court's finding that Timken Roller Bearing, an Ohio corporation, had violated the Sherman Act by entering agreements with two foreign joint ventures, British Timken and French Timken, to allocate territories and fix prices. The Court rejected Timken's argument that these restraints on trade were ancillary to a legitimate joint venture: "Nor do we find any support in reason or authority for the proposition that agreements between legally separate persons and companies to suppress competition among themselves and others can be justified by labeling the project a 'joint venture.' Perhaps every agreement and combination to restrain trade could be so labeled." Id. at 598, 71 S.Ct. at 974–975. See also United States v. American Tobacco Co., 221 U.S. 106, 31 S.Ct. 632, 55 L.Ed. 663 (1911).

On the other hand, as a leading District Court opinion has noted, "[i]t is settled that joint manufacturing ventures, even in domestic markets, are not made unlawful per se by the Sherman Act, but become unlawful only if their purpose or their effect is to restrain trade or to monopolize." United States v. Imperial Chemical Industries, 100 F.Supp. 504, 557 (S.D.N.Y. 1951). Judge Ryan continued:

> But the proof here shows an American concern, already established in a foreign local market, and a British concern, which has a foothold in the same foreign local market, combining to form a jointly owned company to the end that the same foreign market may be developed for their mutual benefit and profits divided on an agreed basis. To this, and as an incident to the formation of the foreign company, we find added by agreement not only joint contribution of capital investment but a pooling of patents and processes owned by the parent companies. . . . [T]he very purpose with which the foreign companies here involved were conceived and the circumstances under which they were born place them under the bar.

Another leading District Court decision emphasized the effect of a foreign manufacturing joint venture on exports by domestic competitors. In United States v. Minnesota Mining & Mfg. Co., 92 F.Supp. 947 (D.Mass.1950), American producers of coated abrasives controlling four-fifths of exports from the United States formed the Durex Corporation, which, through its foreign subsidiaries, conducted manufacturing operations in several foreign countries. Judge Wyzanski found that these joint ventures had the prohibited effect of "precluding their American competitors from receiving business they might otherwise have received from the markets served by these jointly owned foreign factories." Id. at

961. The court also rejected several arguments that the arrangements, though anticompetitive, were beneficial to American interests overall:

> It is no excuse for the violations of the Sherman Act that supplying foreign customers from foreign factories is more profitable and in that sense is, as defendants argue, "in the interest of American enterprise". . . . Financial advantage is a legitimate consideration for an individual non-monopolistic enterprise. It is irrelevant where the action is taken by a combination and the effect, while it may redound to the advantage of American finance, restricts American commerce. For Congress in the Sherman Act has condemned whatever unreasonably restrains American commerce regardless of how it fattens profits of certain stockholders. Congress has preferred to protect American competitors, consumers and workmen.
>
> Nor is it any excuse that the use of foreign factories has increased the movement of raw materials from American to foreign shores. We may disregard the point that the books are not in balance when raw materials actually transported are set off against finished products potentially transported. It is more significant that Congress has not said you may choke commerce here if you nourish it there.

Id. at 962.

As Penn-Olin indicates, joint ventures are typically subject to the same provisions of U.S. antitrust law as other sorts of potentially anticompetitive conduct, including Section 1 of the Sherman Act and Section 7 of the Clayton Act. There are, however, a few kinds of joint ventures for which Congress has enacted specific legislation. In 1919, Congress passed the Webb-Pomerene Act, 40 Stat. 517 (1919), 15 U.S.C.A. §§ 61–66, which allows domestic firms to form export cartels known as Webb-Pomerene Associations so long as domestic competition is not affected:

> Nothing contained in the Sherman Act shall be construed as declaring to be illegal an association entered into for the sole purpose of engaging in export trade and actually engaged solely in such export trade, or an agreement made or act done in the course of export trade by such association, provided such association, agreement, or act is not in restraint of trade within the United States, and is not in restraint of export trade of any domestic competitor of such association: *Provided*, That such association does not, either in the United States or elsewhere, enter into any agreement, understanding, or conspiracy, or do any act which artificially or intentionally enhances or depressed prices within the United States of commodities of the class exported by such association, or which substantially lessens competition within the United States, or otherwise restrains trade therein.

Id. § 62. In 1982, Congress enacted a similar statute, the Export Trading Company Act, 96 Stat. 124 (1982), 15 U.S.C.A. §§ 4001–4021, which allows firms contemplating export activities to apply to the Secretary of Commerce for a Certificate of Review which would immunize the applicant from civil or criminal antitrust liability for actions covered by the certificate that do not adversely affect trade within the United States or the export trade of competitors.

Congress has also acted to protect research and development joint ventures and production joint ventures through the National Cooperative Research Act, 98 Stat. 1815 (1984), and the National Cooperative Research and Production Act, 107 Stat. 117 (1993), which are codified together at 15 U.S.C.A. §§ 4301–4306. These Acts provide that such joint ventures disclosed to the Department of Justice and Federal Trade Commission are to be evaluated under a rule of reason and that private plaintiffs against them are limited to actual (rather than treble) damages. The protection for production joint ventures is available only if the joint venture's principal production facilities are located in the United States and the joint venture's partners are either U.S. persons or foreign persons from countries that treat U.S. persons at least as well as their own nationals with respect to production joint ventures.

Further guidance on the antitrust treatment of joint ventures is provided in the Joint Venture Guidelines issued by the Federal Trade Commission and the Department of Justice in 2000. See Antitrust Guidelines for Collaborations Among Competitors, 4 Trade Reg. Rep. (CCH) & 13,161 (2000). The Guidelines begin by noting: "Such collaborations often are not only benign but procompetitive. Indeed, in the last two decades, the federal antitrust agencies have brought relatively few civil cases against competitor collaborations." Some agreements among competitors are *per se* illegal, including agreements to fix prices or output, rig bids, or divide markets. "If, however, participants in an efficiency-enhancing integration of economic activity enter into an agreement that is reasonably related to the integration and reasonably necessary to achieve its procompetitive benefits, the Agencies analyze the agreement under the rule of reason, even if it is of a type that might otherwise be considered per se illegal." Id. § 3.2. The Joint Venture Guidelines summarize the analysis of agreements under the rule of reason as follows:

> The Agencies' analysis begins with an examination of the nature of the relevant agreement. As a part of this examination, the Agencies ask about the business purpose of the agreement and examine whether the agreement, if already in operation, has caused anticompetitive harm. In some cases, the nature of the agreement and the absence of market power together may demonstrate the absence of anticompetitive harm. In such cases, the Agencies do not challenge the agreement. Alternatively, where the likelihood of anticompetitive harm is

> evident from the nature of the agreement, or anticompetitive harm has resulted from an agreement already in operation, then, absent overriding benefits that could offset the anticompetitive harm, the Agencies challenge such agreements without a detailed market analysis.
>
> If the initial examination of the nature of the agreement indicates possible competitive concerns, but the agreement is not one that would be challenged without a detailed market analysis, the Agencies analyze the agreement in greater depth. The Agencies typically define relevant markets and calculate market shares and concentration as an initial step in assessing whether the agreement may create or increase market power or facilitate its exercise. The Agencies examine the extent to which the participants and the collaboration have the ability and incentive to compete independently. The Agencies also evaluate other market circumstances, e.g. entry, that may foster or prevent anticompetitive harms.
>
> If the examination of these factors indicates no potential for anticompetitive harm, the Agencies end the investigation without considering procompetitive benefits. If investigation indicates anticompetitive harm, the Agencies examine whether the relevant agreement is reasonably necessary to achieve procompetitive benefits that likely would offset anticompetitive harms.

Id. § 1.2.

Echoing the analysis in Penn-Olin, the Joint Venture Guidelines note that the competitive effects of competitor collaborations may differ from those of mergers. First, most mergers completely end competition between the merging parties, while most competitor collaborations preserve some competition between the participants. Second, mergers are designed to be permanent, while competitor collaborations often are not. The Guidelines make clear, however, that the Agencies will analyze a joint venture as a merger if the participants are competitors, the joint venture eliminates all competition between them in the relevant market, and the joint venture does not terminate by its own terms within a sufficiently limited period of time (generally 10 years). Id. § 1.3

Finally, the Joint Venture Guidelines set forth two "safety zones," while emphasizing that "competitor collaborations are not anticompetitive merely because they fall outside the safety zones." Id. § 4.1. First, "[a]bsent extraordinary circumstances, the Agencies do not challenge a competitor collaboration when the market shares of the collaboration and its participants collectively account for not more than twenty percent of each relevant market in which competition may be affected." Id. § 4.2. Second, absent extraordinary circumstances, the Agencies do not challenge research and development collaborations "where three or more independently controlled research efforts in

addition to those of the collaboration possess the required specialized assets or characteristics and the incentive to engage in R & D that is a close substitute for the R & D activity of the collaboration." Id. § 4.3.

In connection with foreign joint ventures, it is also important to recall that under the Foreign Trade Antitrust Improvements Act of 1982 (FTAIA), 15 U.S.C.A. § 6a & § 45a, discussed in Problem 2, supra p. 235, neither the Sherman Act nor the FTC Act applies to anticompetitive conduct involving export commerce or commerce within or among foreign nations unless such conduct has "a direct, substantial, and reasonably foreseeable effect" on domestic commerce, import commerce, or the export commerce of a person in the United States. In other words, joint ventures will be subject to U.S. antitrust law only to the extent that they cause anticompetitive effects in the United States. In United States v. LSL Biotechnologies, 379 F.3d 672 (9th Cir.2004), the Department of Justice challenged a provision in a joint venture agreement between a U.S. company and an Israeli company to produce tomato seeds that precluded the Israeli company from competing in North America. The Court of Appeals upheld the District Court's dismissal on the ground that restraints on competition with respect to tomato seeds in Mexico did not have the "direct" effect on the price of tomatoes in the United States required by the FTAIA.

## 2. JOINT VENTURES UNDER EU COMPETITION LAW

That a joint venture may not be subject to U.S. antitrust law by virtue of the FTAIA or because of the specific exemptions of the Webb-Pomerene and Export Trading Company Acts does not insulate it from scrutiny under foreign antitrust law. In the Wood Pulp Case, Åhlström Osakeyhtiö v. Commission, [1988] ECR 5193, see supra p. 240, the Court of Justice of the European Union (then the European Court of Justice) rejected the argument that U.S. wood pulp exporters were immunized from the application of Article 101 of the Treaty on the Functioning of the European Union (TFEU) (then Article 85 of the Treaty of Rome) because they had formed a Webb-Pomerene Association. The Court noted: "There is not, in this case, any contradiction between the conduct required by the United States and that required by the Community since the Webb-Pomerene Act merely exempts the conclusion of export cartels from the application of United States anti-trust laws but does not require such cartels to be concluded." Id. at 5244.

The treatment of joint ventures under European Union law has evolved over time. The European Commission has generally distinguished between "cooperative" joint ventures that fall within Article 101 of the TFEU and "concentrative" joint ventures that fall within Article 102.[12] Under EU law, as under U.S. law, joint ventures are sometimes analyzed as mergers. Indeed, the parties will often prefer to

[12] The text of Articles 101 and 102 is set forth in Problem 2. See supra pp. 238–240.

have their joint venture reviewed by the European Commission under the Merger Regulation because it provides greater certainty that the joint venture does not violate EU competition law.

To come within the Merger Regulation discussed in Problem 5, supra pp. 368–377, joint ventures must meet the threshold turnover requirements of Article 1 and must be "full-function" joint ventures—that is, they must "perform[ ] on a lasting basis all the functions of an autonomous economic entity." Merger Regulation Art. 3(4). This latter requirement is elaborated in the Commission's 2007 Consolidated Jurisdictional Notice:[13]

> (94) Full function character essentially means that a joint venture must operate on a market, performing the functions normally carried out by undertakings operating in the same market. In order to do so the joint venture must have a management dedicated to its day-to-day operations and access to sufficient resources including finance, staff, and assets (tangible and intangible) in order to conduct on a lasting basis its business activities within the area provided for in the joint-venture agreement. . . .
>
> (95) A joint venture is not full-function if it only takes over one specific function within the parent companies' business activities without its own access to or presence on the market. This is the case, for example, for joint ventures limited to R & D or production. . . .
>
> * * *
>
> (103) Furthermore, the joint venture must be intended to operate on a lasting basis. The fact that the parent companies commit to the joint venture the resources described above normally demonstrates that this is the case. In addition, agreements setting up a joint venture often provide for certain contingencies, for example, the failure of the joint venture or fundamental disagreement as between the parent companies. . . . This kind of provision does not prevent the joint venture from being considered as operating on a lasting basis. The same is normally true where the agreement specifies a period for the duration of the joint venture where this period is sufficiently long in order to bring about a lasting change in the structure of the undertakings concerned, or where the agreement provides for the possible continuation of the joint venture beyond this period.
>
> (104) By contrast, the joint venture will not be considered to operate on a lasting basis where it is established for a

---

[13] 2008 O.J. (C 95) 1.

> short finite duration. This would be the case, for example, where a joint venture is established in order to construct a specific project such as a power plant, but it will not be involved in the operation of the plant once its construction has been completed.

In Case C-248/16, Austria Asphalt GmbH & Co. OG v. Bundeskartellanwalt (2017), the Court of Justice of the European Union held that only joint ventures that perform on a lasting basis all the functions of an autonomous economic entity fall within the Merger Regulation, because it is only these joint ventures that bring about a lasting change in the structure of the market. Id. at ¶ 22.

## 3. JOINT VENTURES UNDER CHINA'S ANTI-MONOPOLY LAW

China's Anti-Monopoly Law, which came into force on August 1, 2008, does not expressly mention joint ventures but does have a chapter dealing with mergers and other "concentrations of undertakings." Article 4 of the 2014 Guiding Opinion on the Notification of Concentration of Business Operators makes clear that any newly established joint venture under the joint control of at least two companies falls within this chapter. In contrast to the EU Merger Regulation, there is no requirement that the joint venture have a "full function character."

For the first decade MOFCOM administered the Anti-Monopoly Law's chapter on concentration of undertakings, but in 2018 responsibility for all competition regulation was centralized in a new State Administration for Market Regulation (SAMR). The parties to a joint venture are required to file a notification with SAMR if they meet the turnover thresholds set forth in Article 3 of the 2008 Provisions of the State Council on the Notification Thresholds of Concentrations of Business Operators. Specifically, notification is required if during the last financial year (1) the combined turnover of all parties to the concentration was more than RMB 10 billion (U.S.$1.5 billion) worldwide or more than RMB 2 billion (U.S.$300 million) in the People's Republic of China and (2) at least two of the parties each had turnover in the People's Republic of China of more than RMB 400 million (U.S.$60 million). China has repeatedly fined joint ventures that failed to make the required notifications.

Under Article 28 of the Anti-Monopoly Law, SAMR has authority to prohibit a joint venture or other concentration if it "leads, or may lead, to elimination or restriction of competition." Under Article 29, SAMR also has authority "to impose additional, restrictive conditions for lessening the negative impact exerted by such concentration on competition." In 2014, China prohibited the world's three largest container-shipping companies (Maersk, MSC, and CMA CGM) from establishing an association because of concerns about competition in shipping routes to

China. In 2014, China also imposed conditions on a joint venture with Toyota to make batteries for hybrid cars. And in 2019, China imposed conditions on a joint venture with a Dutch company to produce a compound used in Vitamin D, requiring the joint venture to operate independently from the joint venture partners for a period of five years.

## QUESTIONS

**(1)** Would you expect the proposed joint venture agreement to raise U.S. antitrust concerns? Consider Paragraph 11 of the agreement in particular. Does it have the potential to restrict competition in the United States?

**(2)** Would you expect the proposed joint venture agreement to raise concerns under China's Anti-Monopoly Law? Would the parties be required to file notification with SAMR?

**(3)** From the parties' point of view, are there any advantages to a system that reviews proposed joint ventures for antitrust concerns before the joint ventures are established? Do the "safety zones" in the U.S. Joint Venture Guidelines provide the same advantages?

**Additional reading:** On U.S. antitrust law, see 2 Waller, Antitrust and American Business Abroad, ch. 12 (3d ed., looseleaf 1997–) and 2 Fugate, Foreign Commerce and the Antitrust Laws, ch. 11 (5th ed. 1996–). On EU competition law, see Morais, Joint Ventures and EU Competition Law (2013). On China's Anti-Monopoly Law, see Blewett & Bai, Merger Control in China: A Practical Guide, uk.practicallaw.com/W-004-7032 (2017).

**(15)** On p. 471, at the end of the first full paragraph, add the following.

> Although the discussion below frequently uses the provisions of NAFTA as examples, the substantive protections of the USMCA (which replaced NAFTA effective July 1, 2020) are largely the same. Where important differences exist, we have noted them in the further updates below.

**(16)** On p. 475, at the end of line 2, add the following:

> One important substantive change made by the USMCA attempts to limit the use of investor expectations to find a breach of fair and equitable treatment. Article 14.6(4) of the USMCA provides: "the mere fact that a Party takes or fails to take an action that may be inconsistent with an investor's expectations does not constitute a breach of this Article, even if there is loss or damage to the covered investment as a result."

**(17)** On p. 480, after the first full paragraph, add the following:

> The USMCA, which replaced NAFTA on July 1, 2020, made several important changes in procedural provisions, which will be important to future investment disputes brought under that agreement. First, Canada did not join the investor claims annexes of the USMCA, which means that U.S. and Mexican investors cannot bring direct claims against Canada under the USMCA, and Canadian investors cannot bring direct claims against the United States and Mexico. (Canadian investors in Mexico and Mexican investors in Canada can bring direct claims under Chapter 9 of the Comprehensive and Progressive Agreement for Trans-Pacific Partnership, which entered into force between them on December 30, 2018.) Second, the provisions for Mexico-U.S. disputes in Annex 14-D do not allow investors to bring claims for indirect expropriation or for denial of fair and equitable treatment, two of the most common claims under NAFTA. Third, Article 14.D.5 imposes a limited exhaustion requirement, requiring an investor to seek relief in the domestic courts or administrative tribunals of the host state for at least 30 months before bringing a claim in arbitration. But, fourth, Annex 14-E withdraws the second and third changes for claims under "covered government contracts"—that is written agreements with a national authority of host state in the sectors of oil and gas, power generation, telecommunications, transportation, and ownership or management of infrastructure. Investors under such contracts—most prominently U.S. investors in Mexico's oil and gas sector—need not exhaust domestic remedies and may make claims for indirect expropriation and denial of fair and equitable treatment.