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Microsoft is Facing Excessive Pricing Accusations in China

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The Disputes

Microsoft is sued for alleged excessive pricing in China by Guangzhou Kam Hing Textile Dyeing Co., Ltd. (Guangzhou Kam Hing). In March 2012, Microsoft sued Guangzhou Kam Hing in the Nansha District People's Court (Nansha Court) for using pirated Microsoft software. According to the news report, the Hong Kong parent company of Guangzhou Kam Hing bought genuine Microsoft software in 2002 but had unsuccessfully negotiated with Microsoft for licensing the software to its subsidiaries in mainland China. Guangzhou Kam Hing, located in Guangdong province adjacent to Hong Kong, then installed pirated Microsoft software and was fined by local authorities in 2010 after Microsoft reported the piracy conduct. Subsequently, Microsoft filed a complaint to the Nansha Court, claiming damages of CNY 4.7 million and requiring that Guangzhou Kam Hing purchase a certain quantity of genuine Microsoft software at a certain price.

During the court hearing on 1 November 2012, Guangzhou Kam Hing brought a counterclaim, accusing that Microsoft had abused its dominant position by demanding Guangzhou Kam Hing purchase Microsoft software in full, which would squeeze out competitors, and by engaging in geographic price discrimination. The Nansha Court told Guangzhou Kam Hing that it should bring a separate antitrust suit before the Guangzhou Intermediate People's Court (Guangzhou Court) because the Nansha Court has no jurisdiction over monopoly disputes.

On 21 November 2012, Guangzhou Kam Hing submitted a complaint to the Guangzhou Court, alleging that Microsoft had abused its dominant position by applying quantity restrictions to reinforce its dominant position, charging excessive prices, and gaining monopoly profits. According to sources familiar with the case, the price of the disputed Microsoft software in mainland China is around 50 percent higher than that in Hong Kong. It seems that Guangzhou Kam Hing chiefly relies upon the excessive pricing claims and has given up the previous discriminatory pricing allegations. The Guangzhou Court has accepted Guangzhou Kam Hing's complaint.

The Law

China's Anti-Monopoly Law (AML) does not prohibit attempts to acquire a dominant

position but prohibits the actual abuse of such a position. Article 17 of the AML provides an illustrative, non-exhaustive list of behaviour that may be considered as abusive, covering both exploitative and exclusionary practices. Dominant companies are prohibited from selling products at unfairly high or buying products at unfairly low prices.

Article 11 of the Measures on the Prohibition of Price Monopoly promulgated by the National Development and Reform Commission (NDRC) provides for a number of factors that should be taken into account when determining whether a price is unfairly high or low under Article 17 of the AML. These factors include: (1) whether the price is obviously higher or lower than that of the same type of product sold or bought by other business operators; (2) where the cost is stable, whether the increase of the selling price or the decrease of the buying price exceeds the normal level; (3) whether the rate of increase in the selling price of a product is obviously higher than the rate of increase in its cost, or whether the rate of decrease in the buying price is obviously higher than the rate of the cost decrease of the trading party; and (4) any other relevant factors that need to be considered.

Article 17 of the AML also prohibits dominant companies from charging discriminatory prices on trading parties in comparable situations without justification. It is noteworthy that, Article 17 of the AML does not explicitly require that, for a discriminatory pricing conduct to fall foul of the AML, it needs to leave trading parties at a competitive disadvantage.

According to Article 8 of the Supreme People's Court Provision on Several Issues Concerning the Application of Law in the Trail of Civil Dispute Cases Arising from Monopoly Conduct, if an alleged monopoly conduct falls into an abuse of dominance prohibited under Article 17 of the AML, the plaintiff bears the burden of proof on the dominant position of the defendant in the relevant market and its abuse of such dominant market position. The burden of proof then shifts to the defendant to prove that its conduct is justifiable.

The Climate

The Microsoft excessive pricing case comes amid the recent backlash that multinational companies have discriminated and unfairly exploited Chinese consumers by selling branded products at much higher prices and sometimes lower standards in mainland China than elsewhere in the world market. Nike was fined CNY 4.87 million in Beijing in October 2012 for selling the same model of basketball shoes at a higher price but lower standards. It is unclear which laws or regulations were relied upon and how the fine was calculated in the *Nike* case. A commentary recently published at the People's Daily provided quite detailed comparisons between prices within and outside of China for a number of branded clothes, sportswear, cars, cosmetics, coffee, milk powders, watches, electronic products, etc. The commentary noted that the factors of customs, transportation, distribution and marketing still could not explain the significantly high prices of international brands in China.

The Test

Professor Xu Guangyao of the Nankai University School of Law has commented that the cost of software products comprises mainly of research and development while production and transportation do not contribute to the cost differences. If Microsoft cannot account for the significant price difference for the same software in Hong Kong and mainland China, then Professor Xu considers that Microsoft's conduct may constitute excessive pricing.

In other words, if Guangzhou Kam Hing successfully establishes Microsoft's dominant position in the relevant market and provides evidence that the prices of Microsoft software products in mainland China were 'unfairly high' by reference to the prices of the same products in Hong Kong, then the evidential burden rests with Microsoft to rebut the dominance and to defend the contested pricing is otherwise 'fair'.

Leaving aside the uncertainties in market definition and establishing dominance, in any event, it is difficult to determine whether a price is unfair or excessive. The process normally involves assessing the cost structure of the disputed products that is then used to establish a competitive price. The track record of the NDRC and the courts has yet to specify how the fairness of a price will be determined under the AML. Although the NDRC had investigated and punished monopoly pricing conduct in the *Reserpin*e case in 2011, the case had relatively simple facts and provided little guidance for the present one.

In the present case, the mere fact that the same products are priced differently in different geographic markets does not necessarily constitute an abuse. If cost-price comparison, as provided by the NDRC Measures on the Prohibition of Price Monopoly, is used in order to find excessive pricing, Microsoft's past research and development costs, including those failed to result in commercialization, will also need to be considered. The assessment can lead to lengthy and expensive trials and may prove to be a mission impossible.

The stakeholders may however learn from the lessons on excessive pricing offered by the EU case law. For example, the European Commission said in *Scandlines Sverige v Port of Helsingborg* that the economic value of the products had to be determined with regard to the particular circumstances of the case and taking into account non-cost related factors. Based on the reasoning of the European Court of Justice in *Deutsche Grammophon v Metro*, one may argue that it could be a determining factor if the price difference of the disputed products in mainland China and Hong Kong is so significant and unjustified by any objective criteria.

A key point to bear in mind is that antitrust law is not a proper tool for price control. Undue interference with high prices and handsome margins *per se* is just like killing the goose that lays the golden eggs and companies may be discouraged from innovation, investment, and cost savings. On the other hand, antitrust law should not open the door for monopolists to maximize their profits by setting prices as long as the customers can bear or have no other options. As commented by the England and Wales Court of Appeal in *Attheraces Limited v The British Horse Racing Limits and others*, abusive pricing claims may present the court 'with a range of factual and legal problems of a kind which even specialist lawyers and economists regard as very difficult'. The Microsoft excessive pricing case challenges the Guangzhou Court's

wisdom in dealing with controversial antitrust matters and private enforcement is once again stands on the front line of a nascent antitrust jurisdiction.

Notes:

1. The NDRC is one of China's three Anti-Monopoly Enforcement Agencies and is responsible for enforcing price-related infringements of the AML in the areas of restrictive agreements and abuse of dominant market position.

2. For more information of the Supreme People's Court judicial interpretation, the *Nike* case, and the *Reserpine* case, see the China Competition Bulletin, Edition 20, May 2012, Edition 23, September/October 2012, and Edition 15, May 2011, respectively.

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