CPI's Asia Column Presents:

Competition Enforcement against Unfairly High Prices in China

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Recently, the Anti-monopoly Bureau of the PRC State Administration for Market Regulation ("SAMR") handed down a large fine of RMB 325.5 million to three sales enterprises engaging in the trading of calcium gluconate BPC (bulk pharmaceutical chemical), arousing great attention both inside and outside the industry. Following the recent Qualcomm abuse case, this is the second monopoly case concerning unfairly high prices that was resulting in fines of over RMB 100 million. In view of this, the article seeks to dig into similar cases concerning the anti-monopoly law enforcement against unfairly high price in China and other jurisdictions as well as the anti-monopoly law theory basis behind, and thereby presents some observations and thoughts on the regulation of unfairly high price.

I. Cases Concerning Unfairly High Price Brought by the Chinese Anti-monopoly Law Enforcement Agencies

Article 17 of the Anti-monopoly Law prohibits undertakings with market dominance from abusing that dominance by selling commodities at unfairly high prices. Based on the cases published by the Chinese anti-monopoly law enforcement agencies,[2] as of April 2020, they had brought a total of 7 cases concerning unfairly high prices. The details of these cases are as follows:

Year	Case name	Illegal conducts
2020	Monopoly case concerning injectable calcium gluconate BPC	· **Unfairly high price** (selling injectable calcium gluconate BPC) · **Imposition of unreasonable terms**
2018	Monopoly case concerning injectable chlorpheniramine BPC	· **Unfairly high price** (selling chlorpheniramine BPC) · **Refusal to deal** · **Tying and bundling**
2017	Monopoly case concerning isoniazid BPC	· **Unfairly high price** (selling Isoniazid BPC) · **Refusal to deal**
2016	Monopoly case concerning gas plumbing services	· **Unfairly high price** (charging for the installation of natural gas plumbing for non-residents) · **Restriction on trading counterparty**
2015	Monopoly case concerning Qualcomm's patents	· **Unfairly high price** (charging patent license fee by taking the price of the finished mobile product as valuation basis; charging for expired patents)

		· **Tying and bundling** · **Imposition of unreasonable terms**
2015	Monopoly case concerning ligustrazine hydrochloride BPC	· **Unfairly high price** (selling ligustrazine hydrochloride BPC)
2013	Monopoly case concerning fluvial sand	· **Unfairly high price** (selling fluvial sand)

**Note: the listed year of each case reflects the date it was publicly disclosed*

In general, the Chinese anti-monopoly law enforcement cases concerning unfairly high price have several features:

First, among all cases concerning abuse of market dominance, **the number of cases concerning unfairly high prices is less than that of cases concerning either tying and bundling / imposition of unreasonable terms or restriction on a trading counterparty**. As the statistics revealed in our previous article "Brief Analysis on the Chinese Anti-monopoly Enforcement in the Past Five Years", in the past five years, there have been 25 cases concerning tying and bundling / imposition of unreasonable terms, and eight cases concerning restriction on a trading counterparty, but only five cases concerning unfairly high prices.

Second, **the cases concerning unfairly high prices only involve a limited number of industries**. Of the seven cases listed above, four involve the BPC industry, two involve natural resources (natural gas and fluvial sand), and the last case (concerning Qualcomm) is relatively special, involving specific patent licensing business in the telecoms industry.

Third, in cases concerning unfairly high prices, **usually the enterprises involved implement other conduct such as refusal to deal, tying and bundling or imposition of unreasonable terms** to sell goods at an unfairly high price.

II. Challenges of Determining Unfairly High Prices

It is generally believed that an enterprise should have pricing autonomy, as a consequence of its economic freedom. Thus, it is confronted with multiple challenges to make clear rules to regulate the unfairly high price in light of the value pursued by the anti-monopoly laws:

1. Should there be competition enforcement against unfairly high prices?

There has been a longstanding debate over whether anti-monopoly laws should regulate unfairly high prices, the core of which is twofold:

First, the market economy has inherent self-corrective mechanisms, which mean that high profits will attract new market entrants and trigger price competition. The prohibition of high prices (even if it is only directed against undertakings with market dominance) may be deemed to be excessive intervention on the one hand, and may on the other hand undermine the investment incentives of potential entrants in a particular market or inhibit undertakings' willingness to innovate.

Second, it is also debatable whether pricing behavior should be regulated through anti-monopoly laws even in the event of market failure in certain industries. One argument is that market failures in specific industries should be handled first by the competent industry regulators and anti-monopoly laws should be the last resort only when the competent industry regulators are incapable of working out a solution.

2. How to determine an unfairly high price?

How to determine whether prices are unfairly high is a technical challenge for competition enforcement. The *Interim Provisions on Prohibition of the Abuse of Market Dominance* ("Interim Provisions") released by the SAMR has provided the following analytical framework for determining the existence of an unfairly high price:

- whether the selling price is evidently higher than the prices set by other undertakings for sale of the same or comparable commodities under identical or similar market conditions;
- whether the selling price is evidently higher than the price set by the same undertaking for sale of commodities in other regions with identical or similar market conditions;
- subject to basically-stable costs, whether the selling price is raised beyond a normal range; and
- whether the price increase for sale of commodities is evidently higher than the cost increase range.

These provisions do not provide any quantitative indicators to determine either "high prices" or "unfair prices." Therefore, a case by case analysis based on legal and economic toolkits is needed in practice. From the perspective of the law enforcement agencies, the major challenge is to strike a delicate balance between pros and cons of regulation in specific cases, that is, how to tackle the problem prudently and avoid over-intervention? From the perspective of the enterprises, the major concern lies in determining *ex ante* compliance, that is, how precisely to assess the legality and rationality of their pricing behavior.

The problems involved are manifold, for example: (1) since demand is another factor other than the cost affecting the price in the market economy, how to assess the influence from the demand side when determining an unfairly high price? (2) when adopting the cost-price comparison approach to determine the unfairly high price, how to find an objective basis for calculating a reasonable margin, that is, how to define the so-called "normal range" mentioned in the Interim Provisions? (3) given that an enterprise's accounting cost usually differs from its actual economic cost because the enterprise tends to define and record its costs in a favorable way based on financial and tax considerations, which criteria should be adopted to determine costs? (4) since seemingly high profits may be deemed to be normal returns taking potential risks into consideration when pricing, should such risk factors be taken into account when calculating the cost?[3]

III. Unfairly High Prices Under Anti-monopoly Law Theories

We note that the academic discussion of whether unfairly high prices should be regulated has passed the phase of binary opposition between yes or no, and academia tends to favor a compromise for "prudent regulation." The various concerns expressed by opponents in the past are highly valued on the one hand while the necessity and feasibility of regulation of unfairly high prices is also recognized on the other.

In terms of necessity, certain markets cannot self-correct within a reasonable period of time due to barriers to entry such as the difficulty of acquiring certain key IP, legal barriers, and network effects. In terms of feasibility, though it is difficult to draw a clear, precise and universally applicable line to determine an unfairly high price, it cannot be denied that in a particular cases there may be abnormally high prices, so high that they even reveal themselves to be unfairly high without being analyzed further. In addition, anti-monopoly law enforcement agencies can reduce the likelihood of enforcement errors by adopting multiple comparative approaches at the same time.

The "prudent regulation" view is that if no exclusionary conduct (such as restriction on trading counterparty and refusal to deal) or conspiracy (a horizontal monopoly agreement to monopolize high prices) is involved, the excessive pricing matter is usually considered as a temporary market failure that can be corrected by the market itself or through industry regulation.[4] In consideration of the numerous technical challenges for regulating prices, and the potential impediment to market innovation and economic development as a result of erroneous interventions, the cost of over-intervention will be significantly higher than that of insufficient intervention. Therefore, anti-monopoly regulation of unfairly high prices should be implemented with particular prudence.

IV. Competition Enforcement Against Unfairly High Prices in U.S. and EU

1. US: excessive pricing *per se* is not prohibited

Unless the excessive pricing is accompanied by anti-competitive conduct prohibited by the antitrust laws, U.S. competition enforcement does not intervene against pure excessive pricing conduct. The US Supreme Court held in the case of *Verizon v. Trinko*[5] that "*The mere possession of monopoly power, and the concomitant charging of monopoly prices, is not only not unlawful; it is an important element of the free-market system. The opportunity to charge monopoly prices—at least for a short period—is what attracts 'business acumen' in the first place; it induces risk taking that produces innovation and economic growth.*"

2. EU: excessive pricing is subject to prudent regulation

Article 102 of the Treaty on the Functioning of the European Union prohibits undertakings holding a "dominant position" from "directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions." This article is the legal basis for the prohibition of predatory prices and unfairly high prices (usually referred to as the "excessive pricing"). Generally, the European Commission and European Court of Justice are prudent as regards enforcement against excessive pricing. According to statistics from some scholars, the European Commission only adopted six formal decisions concerning excessive pricing during

the period from 1957 to 2013, which means, on average, there is less than one decision per decade.[6]

(1) Basic approach to determining excessive pricing: the cost-price comparison approach

The European Court of Justice established the cost-price comparison approach as the basic approach on determining the unfairly high price in the United Brands case (also known as the "Banana Case")[7]. In this case, the court held that "*a price is unfair if it has no reasonable relation to the economic value of the product.*" For this purpose, the court established the following rule:

> "*The questions therefore to be determined are whether the difference between the costs actually incurred and the price actually charged is excessive, and, if the answer to this question is in the affirmative, whether a price has been imposed which is either unfair in itself or when compared to competing products.*"

Under this rule, the determination of an unfairly high price is subject to a twofold test: first, the price must be shown to be excessively high compared to the cost of the product; second, the price must be shown to be higher than the economic value of the product (and therefore unfair). In this case, the court ruled against the European Commission in view of its failure to provide the costs of the bananas sold by United Brands.

(2) The evolution of the approach to determining excessive pricing

The cost-price comparison approach may be unfeasible or insufficient in some cases. For example, in some cases, it is difficult to acquire relevant cost information, or in some cases related to intellectual property licensing, as the marginal cost is extremely low, the cost-price comparison approach cannot work effectively. Accordingly, based on various benchmarks other than the cost, the EU agencies and courts have developed other approaches. In practice, the commonly used comparison approaches include:

- Price-based comparison approaches: compare the investigated undertaking's product price with its own prices (i) in other geographic markets, or (ii) at other periods; or compare such prices with other competitors' product prices (i) in the same market, or (ii) in other comparable market.
- Profit-based comparison approaches: compare the investigated undertaking's profits with (i) normal competitive profits or (ii) other competitors' profits.

The EU law enforcement and judicial agencies further clarified the application of the aforesaid approaches in different cases. In general, current practices tend to apply multiple approaches to determining excessive pricing on a case-by-case basis with a view to avoid excessive intervention. For example, in the Port of Helsingborg case,[8] the European Commission indicated that when determining whether a price is excessive or not, it is also necessary to consider factors which are irrelevant to the cost, especially factors from the demand side. The reason for this is that consumers have greater willingness to pay for products they deem worthy, therefore, a high price does not necessarily imply unfairness. Accordingly, when determining excessive pricing, price-based comparison approaches should also be considered together with the cost-price analysis, and special attention should be paid to the

correct approach to apply. In general, the ideal benchmark should be the price of substitute products provided by competitors in the same market. If the prices of such substitute products are unavailable, then the benchmark may also be the price of the same products provided by the investigated undertakings in other markets. If this price is also unavailable, then the benchmark price may be for similar products provided by other undertakings in other comparable markets.[9]

(3) Enforcement trends in pharmaceutical industry

As a stark contrast to the traditionally conservative stance (especially in the intellectual property field), remarkable changes in recent years are arousing great attention, especially the urge for regulation of pricing in the pharmaceutical industry, which has led to several cases against pharmaceutical giants in Europe. Representative cases include the Pfizer Inc. and Flynn Pharma Ltd. case[10] (excessive pricing of anti-epileptic drugs in UK), the Napp Pharmaceuticals Ltd. case (excessive pricing and predatory pricing in UK), and the Aspen Pharmacare case (the European Commission's first antitrust investigation into excessive pricing in the pharmaceutical industry; as of the date of this article, the case is still under investigation).

V. A Retrospective of Chinese Anti-monopoly Enforcement Against Unfairly High Prices

1. General position

Considering the short history of the Chinese Anti-monopoly Law, the number of enforcement cases indicates that the Chinese agencies have a relatively positive attitude towards the regulation of unfairly high pricing. Nonetheless, in comparison with international theory and experience, it is not difficult to see that the Chinese anti-monopoly law enforcement agencies generally hold a prudent position consistent with the international community in its enforcement against unfairly high prices. First, as mentioned above, when compared with enforcement against other monopoly conduct, unfairly high prices have seen limited enforcement, and this focuses on specific industries with high entry barriers and market failures. Second, except for a few old cases, most cases concerning unfairly high prices also involve exclusionary conduct, indicating that excessive pricing combined with exclusionary conducts is the focus of competition enforcement due to its more severe anti-competitive effects.

2. Enforcement approaches

The basic analytical methods for determining unfairly high price provided for in the Interim Provisions are the cost-price comparison approach and the price-based comparison approach, which is consistent with the analysis framework used in EU's enforcement practice. In terms of enforcement against unfairly high prices in China, we have observed the following trends:

- Cost-price analysis and historical price analysis are frequently used. When adopting the historical price comparison approach, whether there are other factors that may affect the price (such as changes in supply and demand) is also concurrently taken into consideration. Moreover, the Chinese agency tends to apply several approaches in individual cases.

- In individual cases,[11] in addition to cost-price analysis, the Chinese agency also concurrently considers prices set by other undertakings in the same period under normal competitive market conditions (however, there are no further details available on "other competitive undertakings" and the comparable prices of such competitors).

Unlike in the EU, it seems that the Chinese agency does not have a separate "unfairness" test. In other words, if a given price is "high" based on the relevant comparison criteria, it will necessarily be deemed to be "unfair".

3. Breakthroughs and prospects

It is worth mentioning that of the past cases investigated and penalized by the Chinese agencies, undoubtedly Qualcomm is the most eye-catching one. Apart from the sky-high fine, the most important thing is that the case broke with the extremely prudent and conservative position traditionally held in the theoretical and practical circles when applying the theory of unfairly high prices to pricing conduct involving IP rights. Despite the controversy about applying regulations in that case, it sent a clear signal: the field of intellectual property is not a "land beyond the law" for the theory of unfairly high prices. In cases involving intellectual property, even when costs are difficult to calculate and appropriate comparable prices do not exist, the agency may apply qualitative analysis to determine what they consider to be "extremely obvious" unfairly high prices.

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[2] Statistics based on public information that may be partial.

[3] MEI Xiaying & RENG Li: On the Application of Unfair and High Price in Antitrust Law, published in Hebei Law Science, No. 4, Vol. 35, April 2017.

[4] OECD, Policy Roundtables: Excessive Prices, 2011, pp.8-11

[5] See *Verizon Communications Inc. v. Law Offices of Curtis v. Trinko LLP*, 540 U.S. 398, 407, 124 S. Ct. 872 (2004).

[6] David S. Evans, ZHANG Vanessa Yanhua, ZHANG Xinzhu: International Experience and Ispiration on the Anti-monopoly Law Regulations Against Unfairly Pricing, published in China Prices, Vol. 5, 2014.

[7] UNITED BRANDS v. COMMISSION. In Case 27/76 [1978].

[8] Case COMP/A. 36. 568/D3 *Sundbusserne v. Port of Helsingborg* [2006] 4 CMLR23.

[9] *Id.* endnote ii.

[10] The UK Competition and Markets Authority issued a £90 million fine to Pfizer and Flynn Pharma for their excessive pricing conducts, but such decision was subsequently overturned by the UK Competition Appeal Tribunal.

[11] Monopoly case concerning gas plumbing services.