

Complaint to the Commerce Commission  
by Infrserv Limited  
As to certain anti-competitive behaviour of  
Microsoft NZ Limited

## 1 . P r e a m b l e

- 1.1. Microsoft announced last year that it was changing its licensing programme. A key feature of that new licensing programme was the elimination of its previous practice of providing 'upgrades' to existing licensees.
- 1.2. 'Upgrades' are subsequent release of a software product with new features and corrections of defects. 'Upgrades' are common industry practice to the extent that the custom is an expectation of customers at the level of an implied term. 'Upgrades' are distinguished from an original license by two features; first, a price-discount on the new license fee and secondly, the requirement for an existing license.
- 1.3. Microsoft has delayed the introduction of this new programme on at least 2 occasions. The currently announced date for removal of the right to upgrades is 31 July 2002.
- 1.4. To avoid having no right to upgrade, Microsoft customers must be entitled to a license of a recent release of the licensed product. [This lack of precision as to entitlements is part of the complaint.]
- 1.5. Microsoft's proposed new contracts seek to achieve the 'saving' of the previous right to upgrade by substituting right to 'buy' upgrades in advance (the so-called 'Software Assurance' programme) or by requiring customers to have bought into a Microsoft programme that preserves the upgrade rights. [Again this lack of precision as to entitlements is part of the complaint.]
- 1.6. Microsoft's announced strategy is that these changes are part of its responding to technological change and what it describes as the inevitable move to a 'software-as-a-service' distribution paradigm. Microsoft's executives have been reported to use the term 'annuity' to refer to cashflow implications of this change. Simply, this change appears to be about changing the customer base from buying product based on the consumer assessment of the utility of the upgrade to the buying of upgrades by way of a 'service'.
- 1.7. Consumers for example running Windows 98 and effectively now deemed an obsolete product by Microsoft that do not buy one of the new programmes by 31 July 2002 will purportedly have no upgrade rights. If such a consumer chooses not to pay to preserve their upgrade rights, to upgrade after 31 July 2002 that consumer will have to buy an upgrade by buying a completely new licence. No credit will be given for the previous licence expenditure.

- 1.8. Licensees around the world have complained about numerous aspects of this new programme including:
  - 1.8.1. the confusing nature of the programmes
  - 1.8.2. the lack of clear documentation
  - 1.8.3. the absence of contract wordings
  - 1.8.4. the removal of commonly accepted implied rights especially the presumptive right of loyalty programme discounts on upgrades
  - 1.8.5. price increases
  - 1.8.6. lack of fairness and/or certainty as to the new proposed rights under the new Software Assurance programme
  - 1.8.7. the implications for consumers by removal of their choice of control over upgrading strategies.
- 1.9. Microsoft has a substantial degree of market power in the market for computer operating systems and server-based and client-based applications.

## 2. Complaint

- 2.1. The Complainant, Infrserv Limited, a company that owns and operates the computing infrastructure of the Auckland law firm known as Clendon Feeney, is a licensee of both Microsoft operating systems and application products.
- 2.2. Infrserv and Clendon Feeney have been continuous licensees and users of Microsoft operating systems and application products since 1990. The software in use is essential to the operations of Infrserv and Clendon Feeney.
- 2.3. Infrserv has a policy of being on the latest release of the major Microsoft products that are demonstrated to be stable. These products form the foundation of its computer systems. The policy has been implemented to ensure interoperability in exchange of electronic information, security and to enable the firm's investment in human capital to remain at the same value.
- 2.4. The Microsoft products in use include:
  - 2.4.1. the MS Windows operating system (client version)
  - 2.4.2. the MS Window server operating system
  - 2.4.3. MS Office Professional bundle

- 2.4.4. MS BackOffice Server bundle.
- 2.5. The Complainant alleges that the actions of Microsoft in changing its licensing system to remove the previous right to upgrades via the product release model rather than the proposed either software-as-a-service model or re-buy-the-product model results in contracts that lessen competition in a market.
- 2.6. The Complainant further alleges that the actions of Microsoft in changing its licensing system combined with certain other actions, such as changes in the composition of certain bundled products, are an exercise of its market power designed to prevent or lessen competition.
- 2.7. The Complainant further alleges that the actions of Microsoft in changing its licensing system will result in disadvantage to the Complainant and all similar consumers because the new licensing programme will result in refusal to supply on terms that are as favourable as Microsoft is offering to treat with other persons to whom the same goods will be supplied.
- 2.8. The Complainant further alleges that the action of Microsoft, in changing its licensing system, is taking advantage of its market power for prohibited purposes.

### 3. Market Definition & State of Competition

- 3.1. The market is the market for computer operating systems and server and client based applications in New Zealand.
- 3.2. Microsoft has substantial market power in the following markets for software:
  - 3.2.1. desktop, portable and server computer operating system market through Windows in all its forms
  - 3.2.2. client and server based applications in the office productivity suite market through MS Office and each of its component products when sold individually
  - 3.2.3. email, messaging and calendaring through MS Exchange and Outlook
  - 3.2.4. business graphing through MS Visio
  - 3.2.5. project management through MS Project
  - 3.2.6. programming tools associated with the above products particularly the MS Visual Basic for Applications product.
- 3.3. The state of the markets has been characterised by lessening of competition.

- 3.4. Microsoft has been subject to numerous actions in other parts of the world relating to its anti-competitive behaviour. The actions of Microsoft in those markets, being global markets in all the above-listed product markets, have the same anti-competitive effects in New Zealand. The only difference is our competition law regime and the enforcement and remediation options that arise from our legal regime.
- 3.5. Microsoft's distribution model in New Zealand is a combination of direct and indirect channels. Service from Microsoft's distributors has been subject to criticism due to:
- 3.5.1. difficulty in obtaining product
  - 3.5.2. lack of understanding amongst distributors as to the product offered
  - 3.5.3. alleged low margins contributing to lack of distributor interest in servicing customers
  - 3.5.4. unwillingness to invest because of the conflict in the role in the channel with Microsoft's announced strategy of moving to a 'utility' model with its software-as-a-service plans which implies elimination of the distribution channel role at some time in the future
  - 3.5.5. the highly preferential status and lower costs associated with being a 'Select' customer that is able to contract with Microsoft directly and thereby avoid the inconvenience and costs associated with dealing with the Microsoft distribution channel.

## 4. Evidence

- 4.1. Evidence of the alleged conduct is available from the Complainant in the form of emails with executives of Microsoft NZ Limited, preserved copies of the Licensing section of the Microsoft's web site and publicity material published by Microsoft on its licensing programme. The complaints as to the conduct have been made in writing to Microsoft since September 2001.
- 4.2. The Open License Program with Software Assurance current documentation dated 1 Oct 2001. This document states that 'Software Assurance' is defined as "...the right to upgrade to, and run, the latest version of that product that we make available during the covered period". This document is remarkable in that despite the accompanying announcements about 'software-as-a-service':
- 4.2.1. There are no services described as being part of the 'Assurance'. The document is characterised by wide limitation and exclusion of liability clauses. It follows that as there are no services described there are no service level warranties.

- 4.2.2. Furthermore, as can be seen from the definition of Software Assurance there are no commitments to deliver any software, whether as services or otherwise, for the money to be paid in advance.
- 4.2.3. Software Assurance charges are set on the basis of a percentage of the list price of the 'product'. This basis for justification of the service charges is intrinsically at odds with the software-as-a-service paradigm and, the Complainant alleges, is illustrative of the lack of recognition of bargain in the new programme. Software Assurance is not 'software-as-a-service' because no services are offered. What is offered is a **right to upgrade** that previously existed without any requirement for advance payment to preserve that right. The Complainant makes this allegation as the only the promise made by Microsoft in the Open License for Software Assurance is the **right to upgrade** for a period of 2 years. The form that upgrades will be distributed to is not certain nor is it clear whether further charges will be payable to exercise that **right**. Microsoft has previously made further charges for such rights in the form of charges for receiving the benefit of the right by way of upgrades on CDs. Accordingly, the Complainant alleges this single promise, to provide the **right** to upgrade, stand in contrast to the public announcements as to 'software-as-a-service', do not properly inform the public as to the nature of the bargain and accordingly are likely to mislead.
- 4.2.4. The period of the contract is less than the expected major upgrade release cycles, in particular for Windows. The effect of this is that consumers that pay for Software Assurance for 2 years may find that no major upgrade is released during that period. If at the end of the 2 year contract period an upgrade is then likely the consumer, despite not having received any upgrade during the term of the Software Assurance contract, will be facing a compelling economic requirement of it, forced by Microsoft's proposed changes, to renew. The reasoning and mathematics of this is very simple. Software Assurance is based on a 29% per annum charge based on the list product price and payable 2 years in advance i.e. 58%. A 2 year contract therefore will have had the consumer, in the case of a 'product' that is not subject to a major upgrade, paying 58% for effectively patch or bug releases. The consumer choice at year 2, faced with having made a considerable investment in Software Assurance and having received no major release, will be **either**:
- to drop out of Software Assurance and face having to re-buy the 'product' (making a 158% cost or more, depending on product pricing at that time) when released **or**
- to renew by paying another 58% of the then list price for the product (although the percentage on renewal is not fixed so the amount could be more) making a total investment over the 4 years of 116%.

In summary, the consumer that buys Software Assurance today will, in such a no-major-upgrade scenario, unless they renew and pay another 58% of the then current license fee will face paying 100% which is a 72% increase or penalty for not renewing. Given the scale of the penalty of dropping out of the programme it might be expected that Microsoft would give consideration to avoiding such a penalty effect by providing countervailing rights to consumers such as credit terms, periods of grace, guarantees as to the cost of renewal and the like. No such terms are offered.

- 4.3. Further evidence is available from a wide variety of public sourced material including:
- 4.3.1. public statements of Microsoft's executives in both local and overseas press, particularly the computer press
  - 4.3.2. Microsoft's web site at [www.microsoft.co.nz](http://www.microsoft.co.nz)
  - 4.3.3. on the internet particularly in Microsoft customer discussion groups,
  - 4.3.4. from competitors of Microsoft in the various markets and
  - 4.3.5. from the many overseas consumer protection and competition regulatory authorities that have or are presently conduct enquiries into the actions of Microsoft.

## 5. Investigations of the Commission

- 5.1. The Complainant requests the Commission to investigate the complaints on the basis that the conduct demonstrates that there is a major market problem. The following are particulars offered in support of the allegation of major market problem.
- 5.1.1. The conduct is occurring where Microsoft, as a supplier, has customers having high switching costs and non-financial barriers to exit. The barriers to exit and switching costs include user retraining, user knowledge, intellectual property invested in documents, processes and knowledge stores. Microsoft's customers having a consequent reduced capacity to substitute are unable to respond to the changes by switching suppliers,
  - 5.1.2. The conduct is occurring where Microsoft, as a supplier, unilaterally changing its terms of trade in a manner that will result in very substantial price increases unrelated to product costs, efficiency or enterprise profitability and is only able to do so because of its market power.

- 5.1.3. The conduct is occurring where Microsoft, as a supplier, is at the same time engaging in misleading and deceptive conduct in its course of conduct designed to effect the anti-competitive outcome, namely the removal of existing implied upgrade rights and substitution with advanced payments to preserve upgrade rights or on the loss of the rights, the loss of the right to upgrade without re-buying the licensed product.
- 5.1.4. The conduct is occurring where Microsoft, as a supplier, due to its market position obtained and maintained through the economics of technology inter-operability, having the character of an essential supplier acting in a manner that ignores the market position of its customers. The market privilege of being an essential supplier should result in competitive conduct that acknowledges the special position obtained by such a supplier.
- 5.2. The Complainant requests the Commission to investigate the complaints on the basis that the conduct demonstrates blatant disregard of the laws of New Zealand.
- 5.3. The Complainant requests the Commission to investigate the complaints on the basis that the conduct demonstrates the case is of critical importance to the national interest in competition in trade and will establish legal precedent in all or some of the following areas.
  - 5.3.1. The rights of globally dominant suppliers to take actions without regard to local market definition and laws
  - 5.3.2. The obligations of globally dominant suppliers that are involved in large intellectual property transfer payments to consider local market conditions as a result of free market access enabled by New Zealand's status as a signatory to various treaties, specifically GATT and its TRIPS provisions.
  - 5.3.3. The constraints that are appropriate where a party has the market power that Microsoft has in the markets especially that power obtained through its essential supplier and/or standards owner status. Microsoft has, being the owner of a technology standard that is not 'open', in particular the Windows operating system, market power that continuously prevents and deters entry and competitive conduct. Software Assurance and the removal of upgrades takes advantage of Microsoft's power in its markets in that consumers that do enter the programme will be 'removed' from the market for at least 2 years. Paradoxically, if Microsoft fails to deliver an value by way of a major release during that period, as the illustration above demonstrates, Software Assurance will likely result in a high degree of renewals as consumers more to protect their then 58% investment by renewing for another 2 years. The result could be that competition in the affected markets may then be restricted, prevented or deterred for up to at least 4 years.

- 5.3.4. The limitations of a market participant such as Microsoft to change long-standing practises that have been the basis of the permission granted by consumers to the company to become an essential supplier.
- 5.3.5. The limitations on a market participant such as Microsoft to move from a product distribution model to a services model with a discriminatory distribution regime that results in those consumers that are not permitted to deal with Microsoft in its new utility model facing resale price maintenance. This is because its software-as-services when sold through the distribution channel is generating such low margins as to inhibit price competition and deliver inadequate customer service. Simply, if Microsoft is now a utility, the question is should it be able to so discriminate between customers that that buy the same goods but at lower volumes, in that such customers will be forced to buy with less choice over bundles of goods and services, the term of contracts offered at the same time as paying higher prices and receiving lower levels of service.
- 5.3.6. The limitations that should be required of a supplier that becomes privileged with an essential supplier position enforced by a dominant market position, very high switching costs, lack of any meaningful ability to switch in any competitively meaningful timeframe and the loss of the value of adopting a technology standard when that standard is closed and not available from any other supplier. To switch for most consumers means an unacceptable loss of the greatest benefit entrusted by consumers to Microsoft as their supplier, namely that Microsoft being the owner of a series of worldwide standards, through its products ensures interoperability and transfer capabilities in each of technology, intellectual property and human capital.

## 6. Remedies

- 6.1. The Complainant advises the Commission that it does not seek any personal remedy. The remedies sought by the Complainant are sought for all Microsoft customers in New Zealand that are only offered the option of accepting or declining Software Assurance or any other programme that Microsoft offers that compels payment for software before it is required by the customer.
- 6.2. The remedies sought by the Complainant are also sought for all customers to ensure that customers are not asked to pay for Software Assurance 2 years in advance when in all likelihood from Microsoft's own announcements some products will not be upgraded within that 2 year period resulting in payment for little benefit and the compulsion to pay yet a further 2 years in advance. This would result in total advance payments of at least 116% of the licence price before a major upgrade is received. This system of contracting will, the Complainant alleges, have a chilling factor on both competition and entry into the market for at least the next four years. Such 'chilling' of competition will substantially lessen competition.

- 6.3. The Complainant requests the Commission consider whether it has the powers and if so the grounds, if the Commission finds any of the behaviours of Microsoft to have amount to resale price maintenance or to have lessened or limited competition, to:
- 6.3.1. recommend to the Minister that the Minister recommend that an Order in Council declare that the goods and services of Microsoft in New Zealand are to be controlled;
  - 6.3.2. that the terms of control include the preservation of the right to upgrade at the historical average discount previously extended by Microsoft to its customers for upgrades in New Zealand;
  - 6.3.3. that the terms of control include the preservation of the rights to upgrades of bundles previously sold by Microsoft to its customers in New Zealand;
  - 6.3.4. that the terms of control also include fixing the cost of ( as a percentage of the license price), term of contract and terms of contract for product maintenance programmes in New Zealand;
  - 6.3.5. that the terms of control also include fixing the cost of product in New Zealand
  - 6.3.6. that the terms of control also include conduct remedies both to redress the effect of previously proven anti-competitive behaviour in the same terms as agreed between Microsoft and the Department of Justice and the States Attorney General's in any orders in the Federal Court in the United States of America. Such orders will need to be modified to reflect the market harm caused in the New Zealand market.
  - 6.3.7. that the terms of control also include conduct remedies to prevent further misleading and deceptive conduct.

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