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Lessons from Microsoft: What the Judgment Means for Companies Doing Business in Europe

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by Christopher Norall, Rony P. Gerrits

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The September 17th judgment of the Court of First Instance ("CFI") in the *Microsoft* case represents a resounding victory for the Commission and a serious defeat for Microsoft. This note examines the background to the judgment, its impact on the EU competition law proceeding against Microsoft, and more generally on enforcement in Article 82 abuse of dominance cases, especially in the high tech sector.

Background

The stakes for the Commission in the *Microsoft* appeal were extremely high.

The case represented the highest profile and most resource intensive Article 82 enforcement action ever attempted by the Commission. The €497 million fine imposed in the Commission's 2004 Decision was the highest ever imposed on a single company, and it was followed in 2006 by a second fine of €280 million for failure to comply with the Commission's remedial order. The Commission's adversary is renowned for its aggressive stance towards regulators, and its track record of tough-minded use of its substantial economic, legal and lobbying resources in its own defense; it had already fought off a parallel antitrust attack in the US.

During the nine years that separated the opening of the investigation and the CFI's judgment, Commission enforcement policy and action concerning abuse of dominance cases, and the closely related field of merger control, had been subject to stinging criticism from a variety of sources. Both the economic theories used by the Commission and the quality of its factual analysis had come under withering comment from the CFI in a series of merger control cases (*Airtours*, *Schneider*, *Tetra Laval;* in addition, although the decision in *GE/Honeywell* was not reversed, much of the Commission's reasoning was rejected by the CFI). There had been a steady chorus of criticism from government officials, legislators and academics in the US, alleging protectionist bias, protecting competitors rather than competition, an economically flawed interest in leveraging theories, and a failure to adequately promote intellectual property and innovation.

Most recently, the value of competition law had been called in question from a completely different quarter - by some leading national politicians inside the EU, most notably the new French President Nicolas Sarkozy. If the Commission had stumbled badly in the *Microsoft* appeal, it would have risked retreat into a ghetto, its main activity processing uncontroversial cartel cases and rubber-stamping mergers.

Time, the media, and globalization of legal procedures played an unusual role in the *Microsoft* case. It concerns leveraging of Microsoft's massively dominant position on the desktop operating system market into two other markets. Microsoft was accused of seeking market power in the low end server market (characterized as the "work group server" segment) by denying interoperability information, and in the media player market by bundling its own media player into the operating system. By the time of the CFI's judgment, the perception commonly found in the media[1] was that Microsoft had succeeded, and the Commission's enforcement action had failed. But, because of the wealth of material that had been generated in the otherwise anticlimactic antitrust proceeding in the

US, what Microsoft had achieved by 2007 could be compared with what its managers had said, internally, that they intended to achieve ten years earlier. Bill Gates' emails and speeches in the 1990's, the march of market share figures for low end servers and media players, and the memory of the fate of Netscape, were the essential backdrop against which the CFI heard Microsoft's criticism of the Commission Decision. Also relevant may have been the spectacle presented to the CFI during the course of the appeal of Microsoft progressively eliminating, by means of financially generous settlements, many of the main trade associations and companies supporting the Commission's position.

The resulting CFI judgment represents a strong endorsement of the Commission's enforcement stance in general, and of its aggressive position on two points in particular: forcing dominant companies to provide interoperability information to competitors together with the related question of compulsory licensing of intellectual property by dominant companies; and bundling to achieve leveraging on the market for the bundled product. While the fate of the markets for low end servers and media players may no longer have much present importance, the CFI's unequivocal confirmation of the Commission's findings and the theories underlying them will strongly boost the Commission's resolve to pursue big ticket Article 82 cases, as well as confirming the availability of these two particular antitrust theories.

The Legal Issues

Faced with the daunting challenge of confronting Microsoft, the Commission crafted its decision by steering a careful and subtle course between invoking well-established precedent on the one hand and drawing out the unique features of the case on the other. The relevant precedents were those relating to refusal to deal and compulsory licensing of intellectual property (in relation to disclosure of interoperability information) and tying (in relation to bundling of Windows Media Player). The Commission argued that Microsoft had foreclosed competition and stifled innovation in these markets.

In response, Microsoft's legal and public relations strategy sought to cast itself as the defender of competition, innovation and the consumer, which would be threatened if the Commission's position was vindicated. The disclosure of interoperability information ordered by the Commission would discourage future innovation by establishing that complainants could use competition law to get the necessary information to clone the products of their successful competitors. A rule prohibiting bundling of new technologies into the operating system would amount to an unjustified ban on dominant companies continuing to develop and improve their products.

The CFI judgment proceeds methodically to consider each component of the Commission's Decision, Microsoft's attack on it, and the Commission's defense of it. It applies the “manifest error” standard of review applicable to complex issues of economic fact. But in doing so, it examines all the arguments in detail. As regards the substantive part of the case, it upholds the Commission on every point, without exception or qualification. Only on the part of the remedy relating to the Monitoring Trustee- his powers and his compensation by Microsoft - does it uphold any of Microsoft's claims.

Interoperability and Compulsory Licensing of Intellectual Property

If there is divergence between US and EU approaches to abuse of market power, much of it is focused on the specific issues concerning the circumstances in which a company having strong market power may have a duty to give competitors access to its property, particularly its intellectual property. The Supreme Court's *Trinko* judgment expresses the general position that US antitrust law rarely if ever imposes such a duty. Two strands of EU competition law adopt a more expansive position, although its scope is not entirely clear. The first strand concerns the “exceptional” circumstances in which the holder of intellectual property may be required to license its rights to a competitor. Under the formula developed in the *Magill* and *IMS* case law, these exceptional circumstances exist when (i) the subject matter of the IPR is “indispensable” for the exercise of an activity on a neighboring market, (ii) refusal of the license excludes any “effective” competition on the neighboring market and (iii) the refusal of the license prevents the appearance of a “new product” for which there is potential consumer demand. The second strand concerns essential facilities - an asset or service held exclusively by one party access to which is necessary to competitors on a neighboring market. Here, the most important precedent is the Court of Justice's judgment in *Oscar Bronner*, the language of which suggests that denial of access is abusive if (i) it is likely to eliminate all competition on the neighboring market, (ii) there is no objective justification and (iii) the access or service is indispensable to operate on the neighboring market “inasmuch as there is no actual or potential substitute” for it. It can be seen that there is some vagueness and unclarity in both tests.

There is overlap between some of the elements. Above all, how stringent is the test of "indispensability" and "likely to eliminate competition"?

In its characterization of the abuse, and still more its formulation of the remedy, the Commission had trod a careful line requiring Microsoft to disclose interface specifications but not source code. Following this line, it could be argued that compliance involved little or no licensing of intellectual property. But at the same time the Commission had insisted that, to the extent the IPR licensing was involved, the *Magill/IMS* test was met. Both the Decision and the Judgment devote considerable space to the question of the quantity and quality of the intellectual property (if any) that might be involved in the disclosure of specifications as opposed to source code.

The Judgmentcuts decisively to the *Magill/IMS* test. Here the key point is that a degree of realism and flexibility is to be applied. "Indispensable" means necessary in order for a product to be marketed "viably". In assessing "likelihood to eliminate competition", Article 82 "does not apply only from the time where there is no more, or practically no more, competition on the market", and it is not "necessary to demonstrate that all competition on the market would be eliminated"; rather what is required is that "the refusal is liable, is or is likely, to eliminate all effective competition on the market. ... [T]he fact that the competitors of the dominant undertaking retain a marginal presence in certain niches on the market cannot suffice to substantiate the existence of such competition.". This is to be established in light of all the facts and circumstances, reviewed by the CFI using the "no manifest error" test for complex questions of economic fact. The CFI reviews the Commission's findings in some detail. In so doing, it brushes aside a number of Microsoft arguments on such subsidiary issues as market definition and calculation of market share. Microsoft had sought to construct an argument to the effect that the definition of interoperability used by the Commission was inconsistent with that found in the Computer Software Copyright Directive and that, if accepted, it would permit competitors to "clone" Microsoft products. The CFI rejects this, stating that competitors will use the interoperability information to develop new and differentiated products in order to compete with Microsoft; it emphasizes the aspect of development and innovation in applying the "new product" test of *Magill/IMS*.

Bundling of Media Player into the OS

Article 82 prohibits abuse of a dominant position and then lists four specific examples of abuse, including in paragraph (d) "making the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts". Historically, the case law can be read as saying that the four cases are inherently exclusionary, so that where a company is dominant and one of the four cases is present, this is sufficient to constitute an infringement, without the need for a further showing of exclusionary effects. The case law also says that the four examples are not limitative, and abuses may be constituted by other conduct that forecloses competition. Recent criticism and comment, reflected in the Commission's own draft White Paper on Article 82, lay increasing emphasis on the need to show foreclosure effects for any allegedly abusive conduct. In this situation, the Commission's strategy was to characterize the bundling of Media Player into the OS as a case of Article 82(d) tying, but to devote substantial fact finding and analysis to showing foreclosure of competition. In reply, Microsoft argued that the Media Player bundling fits neither the language of Article 82(d) nor the classical concept of tying, and that the Commission had invented a new and "speculative" theory of abuse; moreover, bundling new technologies into the operating system was simply a normal evolutionary process of developing and improving the product for the benefit of consumers, with which the Commission's position would unjustifiably interfere. In the background lay the facts that the bundling of Media Player looked much like the earlier episode of the destruction of Netscape by the bundling the Internet Explorer browser, that the market share of competing media players had receded sharply, and that the Commission's remedy – requiring that Microsoft market a version of the OS not incorporating Media Player – had been widely reported to be a commercial failure.

The CFI backed the Commission to the hilt. Assuming this approach is confirmed as the case law evolves (a judgment of the ECJ will probably be necessary for this), the position going forward would appear to be that bundling software by a dominant company is abusive provided a number of elements can be shown. The first is that - at the time when the bundling started - there were separate products; it is not a defense that bundling them subsequently became normal commercial practice, or that there was thereafter little or no commercial demand for the tying product (the OS) without the tied product (the Media Player). Second, technical integration of software code is sufficient to satisfy the "supplementary obligation" requirement. The test is not whether the buyer was forced to acquire a package consisting of two separate components, or to pay more because the tied component was included. Rather, it is whether consumers are deprived of the freedom to

obtain the tying product without the tied product. The CFI lays considerable emphasis on the fact that customers, whether OEMs or end users, did not have the possibility of uninstalling Media Player. The third element is foreclosure of competition. Here, the CFI considers both reasoning on the basis of the structure of the product and the market concerned, and data on the historical market effects occurring since the bundling began. The CFI reviews the Commission's findings in detail, emphasizing the technical aspects of distribution of software, the role of the OEMs, and the possibility of downloading competing media players on the Internet. It also considers the effect of Media Player ubiquity on content providers and software developers.

TRIPS

Microsoft argued, both in the administrative procedure and before the CFI, that in requiring Microsoft to market a version of Windows from which Media Player had been stripped out, the Commission violated the TRIPS agreement. It sought to invoke provisions establishing that any exceptions to trade mark rights must be limited and must take account of the legitimate interests of the owner of the trade mark and of third parties, and that the use of a trade mark cannot be unjustifiably encumbered by special requirements. The CFI replied that, under EU case law, it is required to consider compatibility of a measure with the WTO Agreements only when the measure by its terms implements or refers to them. It also noted that Article 40(2) of the TRIPS agreement contains an escape clause for measures based on competition law.

The Monitoring Trustee

The one point on which the CFI sustained Microsoft was its objection to the powers and compensation (solely by Microsoft itself) of the Monitoring Trustee. The CFI found that the Commission had delegated to the Monitoring Trustee powers which the procedural regulation then in effect, Regulation 17, conferred only on the Commission, and that there was no legal basis under Regulation 17 for forcing Microsoft to pay for enforcement activity which it was for the Commission to conduct. It should be noted that, shortly after the Decision was adopted, the new procedural Regulation, Regulation 1, came into effect. It contains provisions, in particular the possibility to conclude proceedings by the acceptance of behavioral undertakings that then become legally binding, that may provide the Commission, in future cases, with a method of achieving much of what it sought to achieve in the *Microsoft* case with the Monitoring Trustee.

Implications for Business

1. In general, the Commission must have breathed a huge sigh of relief upon hearing the CFI's judgment, and must now feel that the wind is in its sails with respect to Article 82 cases in the high tech sector.
2. The Commission's status as the antitrust authority of choice to which potential complainants in the high tech sector can address themselves is confirmed and consolidated. Potential targets of such complaints will need to be mindful of the Commission's powers and of the legal theories available to it under EU law.
3. Since, in the high tech sector, a majority of both potential complainants and potential targets are US companies, the stage is set for some turbulence in transatlantic antitrust relations. This has already been demonstrated by the Antitrust Division's comment on the Judgment and Commissioner Kroes's reply.
4. The *Magill/IMS* approach to the problem of the duty to license IP has been confirmed as regards new products on adjacent markets; in particular, it has been confirmed that the "risk of eliminating competition" and "new product" are not insuperably difficult.
5. The bundling component of the CFI judgment is perhaps less menacing that it might appear. A dominant company which intransigently insists on bundling may be vulnerable, but if it is willing to show some flexibility in maneuvering, there are many technical devices - relating to the manner in which software permits installation of and access to competing technologies- that are available to eliminate or attenuate the accusation of foreclosure of competition.
6. Although the Commission lost the portion of the appeal relating to the remedy, the new powers acquired by the Commission under Regulation 1 (which was not in effect when the Decision was adopted), in particular the power, after conducting an investigation, to conclude the proceeding with the acceptance of behavioral undertakings which then become legally enforceable, may provide the Commission with additional leverage in these cases.
7. As regards Microsoft, the defensive position which it has laboriously sought to construct over the past decade against antitrust/competition law complaints appears to have been seriously breached. The likelihood that this can be substantially repaired by a successful appeal to the European Court of Justice appears doubtful. In addition to its increased vulnerability to accusations of failure to comply adequately with the Decision, the way appears open to

attacks on such matters as further episodes of bundling, and file format interoperability. Antitrust authorities around the globe may feel emboldened to seek their turn.

[1] *See* "Use the Microsoft Mandate Wisely", Financial Times, September 17, 2007 http://www.ft.com/cms/s/0/2e9336bc-654e-11dc-bf89-0000779fd2ac.html.