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Ekonomihögskolan
Institutionen för Handelsrätt
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The CFI in *Microsoft*
Consumer Welfare, Network Externalities
& The Goal of Competition Policy

Handledare: Henrik Norinder

Författare: Ola Rickardsson

Abstract

This essay aims at interpreting the legal standards of consumer benefits in the CFI judgment *Microsoft v Commission* with regard to refusal to supply interoperability information and tying of Windows Media Player. In the refusal to supply part of the thesis it concludes that the Commission's findings are sound and that Microsoft's behavior had a negative effect on consumer welfare. However, the new incentives-balancing-test provides a lot of legal uncertainty for dominant undertakings which ultimately can discourage dominant companies from investing in R&D which would prejudice consumers in the long run. In the tying part the essay concludes that the CFI has successfully applied the standards from previous case-law on *Microsoft*. However, in this part I argue that the CFI has failed to correctly analyze the market with regard to network externalities and the speed of development. This analysis shines a whole new light on the case and concludes that the tying practice was not to prejudice of consumers.

Keywords: Competition; Consumer welfare; Microsoft; Network externalities; Article 82

Sammanfattning

Denna uppsats syftar till att förklara olika vinklar av konsumentnytta från Förstainstansrättens dom i målet *Microsoft mot Kommissionen*, då speciellt med avseende på licensieringsvägran av interoperabilitetsinformation och kopplingsförbehåll (tying) på Windows Media Player. I delen som rör leveransvägran dras slutsatsen att Kommissionens dokumentation av Microsofts uppträdande är korrekta och att detta uppträdande hade en negativ effekt på konsumentnyttan. Dock ger det nya balanseringstestet en hög grad juridisk osäkerhet för dominanta företag vilket i slutändan kan avskräcka dessa att investera i R&D, vilket i sin tur skulle missgynna konsumenter över tid. I delen som rör tying dras slutsatsen att Förstainstansrätten framgångsrikt applicerat tidigare praxis på *Microsoft*. Dock argumenterar jag här att Förstainstansrätten har misslyckats att bedöma marknaden med hänsyn till nätverkseffekter samt utvecklingshastigheten på marknaden. Denna analys ger en helt annan bild av målet samt drar slutsatsen att Microsofts tying av Windows Media Player inte var till nackdel för konsumenterna.

Nyckelord: Konkurrens; Konsumentnytta; Microsoft; Nätverkseffekter; Artikel 82

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Abbreviations

AG – Advocate General

CFI – Court of First Instance

DG – Director General

DVD – Digital Versatile Disc

EC – European Communities

ECJ – European Court of Justice

IPR – Intellectual Property Right

LRIC – Long Run Incremental Cost

OEM – Original Equipment Manufacturer

OS – Operating System

PC – Personal Computer

R&D – Research and Development

WMP – Windows Media Player

1 Introduction

1.1 Background

On 2 August 2000 the Commission brought their first allegations on Microsoft regarding the interoperability between Windows PC operating systems and other suppliers' server operating systems. This allegation was first brought to the Commission's attention by Sun Microsystems who believed Microsoft was abusing its dominant position on the PC operating systems market.¹ In the same year the Commission started an investigation relating to Microsoft's integration of Windows Media Player (WMP) in its Windows 2000 operating system. This investigation was launched on the Commission's own initiative.² The Commission presented a number of objections which Microsoft responded to. Since the parties could not reach a final agreement the Commission adopted decision COMP/C-3.37.792 which became the contested decision.³

1.2 Introduction

This essay deals with the consumer welfare standard in the CFI judgment *Microsoft Corporation v Commission*.⁴

One of the most fundamental aspects of the EC Treaty is to establish a common market within the Community. In article 2 EC and article 3 (g) EC the member states sets out these provisions by declaring a system that ensures that the competition on the common market is not distorted to the prejudice of consumers.⁵

Further, the Lisbon European Council concluded that the European Union, in a period of ten years, should become "the most competitive and dynamic knowledge-based economy in the world".⁶ Thus an internal market with an effective competitive structure is required.

By what just has been said one could identify three different approaches to competition policy. Firstly, one could identify an all efficiency oriented definition. This definition would favor any conduct which would have a positive effect on the total welfare, even if consumers would be worse off. Secondly, one could

¹ Case T-201/04 *Microsoft Corporation v. Commission* [2007] para 6-8.

² *Op. cit.* para 10.

³ *Op. cit.* para 20.

⁴ *Op. cit.*

⁵ *Joined Cases 6/73 and 7/73 Commercial Solvents*, para 32.

⁶ Presidency conclusions from the Lisbon European Council 23 and 24 March 2000 found at http://www.europarl.europa.eu/summits/lis1_en.htm visited at 1600h 201107.

identify a competition policy which would favor any short-term profits to consumers, and thirdly, one could identify a policy which would appraise the long-term effects of consumer welfare.⁷

It is clear that the first approach to competition policymakers, despite its economic rationale, would not be considered by competition authorities because of other interfering interests.⁸ Competition policy must therefore strive to enhance the total welfare on the market, while providing consumers with a substantial portion of this welfare. This approach has been appraised by the Commission and the Community courts; the question is thus whether one should put emphasis on short-term or long-term benefits.

1.3 Purpose and Subject

The purpose of this essay is to explore the concept of *consumer welfare*⁹ in the *Microsoft* case. It aims to describe the interpretation of consumer welfare in relevant case-law and doctrine, and to analyze the *Microsoft* case with the facts borne from this investigation. It will also put this analysis into the context of the principle purpose of Community competition law and policy.

A central question could be formulated as: Is the *Microsoft* case consistent with previous case-law in regard to the doctrine on consumer welfare? The following analysis will then be guided by the answer to this first subject. If it concludes that it is consistent case-law, will this definition of consumer welfare fulfill the principal purpose of Community competition law? If it concludes that it is not consistent case-law, what possible problems and effects will this expansion of the legal rules have on the competitive structure on the relevant market?

1.4 Method and Materials

We may divide essays into two main groups. These groups characterize by either being rule-oriented or problem-oriented. The rule-oriented seeks to describe the right or true interpretation of legal rules. The problem-oriented would thus put a

⁷ Cseres, Katalin, "The Controversies of the Consumer Welfare Standard", *Competition Law Review*, volume 3, Issue 2, pp. 121-173. (p. 124) see also, Brodley, Josef, *The Economic Goals of Anti-trust: Efficiency, Consumer Welfare and technological progress*. New York University Law Review 1020, p 1035.

⁸ Ibid.

⁹ With the terminology Consumer welfare I also aim to include concepts as *consumer choice* and *consumer benefits*, all relevant within the scope of *Welfare economics*.

factual problem at its center for deeper analysis to describe this problem in the light of legal standards by illustrating its rationality, consequences etc.¹⁰

In the light of the above this essay would be a mix of the two kinds, where the first part would typically be rule-oriented in describing the consumer welfare standard in existing case-law. The result from this first analysis will then be used as a springboard to a more problem-oriented description on the application of the consumer welfare standard.

As the essay aims at interpret the standards of consumer welfare in EC competition law the main source of material will be rulings of courts, opinions of the Advocate generals, policy statements, relevant doctrine and decisions by the Commission. The material will then be used in a legal dogmatic interpretation of the content of the legal rules. I will also provide the reader with the basic economic concepts that the legal rules are based on.

It should be evident that rulings of courts, decisions by the Commission and doctrine serve the primary purpose of interpreting the consumer welfare standards. However, policy statements and opinions of Advocate generals serve the purpose of understanding the context of competition and consumer welfare.

1.5 Delimitations

As the *Microsoft* case has two main parts, the tying of Windows Media Player to Microsoft Windows Operating Systems and the refusal to supply interoperability information protected by intellectual property rights (IPRs), the essay is merely going to define consumer welfare within these two typical abuses, tying and refusal to deal. It is thus noted that it could be possible to find a different scope of consumer welfare in other abuses.

It should also be noted that this essay is one out of four currently being developed in the light of the *Microsoft* case. These works have the following plotlines: Tying – by fellow student Peter Malmgren; Refusal to supply interoperability information – by fellow student Johan Cronqvist; Remedies – by fellow student Tim Sjöström. As these three essays delimit from one another in a reasonable way, the consumer welfare concept is present in all these aspects. It is thus impossible not to overlap in certain parts.

It is however not my intention to evaluate the legal standards of tying and refusal to supply born from the *Microsoft* case, it is instead, as expressed in the purpose and subject subsection, to find the standards of consumer welfare in previous

¹⁰ Westberg, Peter, 1992, "Avhandlingsskrivande och val av forskningsansats – en idé om rättsvetenskaplig öppenhet", *Festskrift till Per Olof Bolding*, Heuman, Lars (ed.), p. 421-446, Stockholm.

case-law and in *Microsoft* and to compare the two by identify similarities and abnormalities, and finally to discuss whether this is sound interpretations of the consumer welfare conception.

I will restrict my analysis to the Community competition law and policy, thus delimiting myself from both US anti-trust policy and case-law, and national competition legislation and case-law.

As should be recognized by the reader of this essay, the *Microsoft* case is an extremely complicated case technologically. Therefore one must realize that it would render impossible to go into detail with regard to the technological issues at hand. In this context, the definitions on technical aspects in the present case must be those adapted by the CFI in its judgment.

1.6 Disposition

I will start by giving an outline of the concept of consumer welfare in chapter 2. In chapter 3 I will start of by describing the fundamental aspects of EC competition law and policy under article 82. I will describe the characteristics of abuses and then analyze existing case-law with regard to the two relevant abuses, refusal to deal and tying. I will also provide some notes with regard to the discussion paper¹¹.

Chapter 4 presents the *Microsoft* case. The relevant parts of the judgment, with regard to consumer welfare, will be described to give the reader an understanding of the Court's reasoning. In chapter 5 I will apply the definitions of consumer welfare described in chapter 2 in conjunction with the fundamental aspects of competition policy and previous case-law presented in chapter 3 to the *Microsoft* case. This chapter is the main analyzing chapter of the essay and will especially discuss the Court's and Commission's consumer welfare analysis to *Microsoft* and what the results of this analysis actually mean.

Finally I will summarize some concluding remarks from the analysis. Conclusions and future question marks for the jurisprudence will be brought forward to answer the guiding purpose of the essay.

¹¹ See section 2.5 for more detailed information.

2 The Concept of Consumer Welfare

This chapter deals with the concept of consumer welfare in its relation to other relevant concepts. The aim is to provide the reader some necessary understanding of economic concepts that are fundamental to understand competition policy.

2.1 General

When discussing competition law in the EU it is normal practice to discuss competition cases in terms of economic concepts.¹² The growing importance of economics in competition law and policy requires a consensus understanding of the terms used when applying economic concepts such as consumer welfare to competition law.

The consumer welfare model in EC competition law mainly aims at preventing dominant undertakings to exercise its market power to raise consumer prices, restrict output or deteriorate product quality to the prejudice of consumers.¹³

2.2 The Consumer welfare standard and the Total welfare standard

The consumer welfare standard is defined as the maximization of consumer surplus.¹⁴ This means the economic benefits, associated with the good, which the consumer receives by the good's price and quality. The consumer welfare standard is thus only one variable which induces welfare in the total welfare standard. The total welfare standard can be described as the standard that strives for the maximization of efficiency for society as a whole, not only consumers.¹⁵

As explained in the introduction, the ultimate goal of competition policy is to increase the overall material welfare of society through maintaining rivalry among firms, thus increasing the total economic efficiency while providing consumers with a substantial part of the total wealth.¹⁶

¹² Faull, Jonathan & Nikpay, Ali, 2007. *The EC Law of Competition*, Oxford. p. 4.

¹³ Cseres, Katalin, "The Controversies of the Consumer Welfare Standard", *Competition Law Review*, volume 3, Issue 2, pp. 121-173. (p. 124)

¹⁴ Consumer surplus is defined as the difference of what consumers are willing to pay for a good or service and what they actually are obliged to pay (the equilibrium price).

¹⁵ Cseres, Katalin, "The Controversies of the Consumer Welfare Standard", *Competition Law Review*, volume 3, Issue 2, pp. 121-173. (p. 126)

¹⁶ *Ibid.*

2.3 Consumer welfare and technological development

One could argue that there is a very strong bond between consumer welfare and R&D. This is because undertakings, according to economic theory, always strive to invent new products or improvements that benefits consumers.¹⁷ The rationale of intellectual property rights is thus to produce the necessary incentives to invest in R&D. Because the IPR forecloses other undertakings the possibility to copy newly invented products this opens up the necessary possibility of recoupment. Without a possibility of recoupment, no undertaking would find it attractive to invent those new features or products that consumers find attractive.¹⁸

2.4 Consumer welfare and Network effects

A network market is characterized by the fact that each new consumer benefits all existing consumers on that particular market. In general network markets offer lucrative returns to those undertakings capable to establish their own product as the de facto standard on which competition on aftermarkets for complementary goods will be based.¹⁹ Network markets are also more sensitive to tipping. The tipping concept is based on a natural tendency towards a de facto standardization, where everyone is using the same system because of strong positive-feedback elements associated with the product, thus excluding all competitors.²⁰ However, the fact that a market tips does not say anything about whether this is good or bad for the market and the consumers. If the market has a tendency to tip, that often means that consumers prefer the standardized product because of this specific characteristic, that it is standardized. However this does not imply that one undertaking should own the standard, or even that it should be owned at all.²¹

One can define two types of network effects, direct and indirect. The direct network effects derive from the fact that when one consumer joins the network he immediately benefits other consumers in the network.²² This can be exemplified by communication networks where every new consumer in the network will give consumers already involved another plausible person to interact with, thus constituting a direct effect. The indirect network effects are those that not benefit the consumers directly, but still have a positive welfare effect on all participants in

¹⁷ Glader, Marcus, 2004. *Innovation Markets and Competition analysis – EU Competition Law and US Antitrust Law*. Malmö. p. 24.

¹⁸ Faull, Jonathan & Nikpay, Ali, 2007. *The EC Law of Competition*, Oxford. p. 1235.

¹⁹ Lemley, A. Mark & McGowan David, “Legal Implications of Network Economic Effects” *California Law Review* Vol 5, p. 24.

²⁰ Katz, Michael L. & Shapiro, Carl, “Systems Competition and network effects”, *The Journal of Economic Perspectives*, Vol 8. No. 2 p. 107.

²¹ Lemley, A. Mark & McGowan David, “Legal Implications of Network Economic Effects” *California Law Review* Vol 5, p. 26.

²² Priest, Jorge L., “Rethinking Antitrust Law in an Age of Network Industries”, John M. Olin Center for Studies in Law, Economics, and Public Policy, Research Paper No. 352. p. 3

the network.²³ This is the case in for example the DVD market. When a new consumer purchases a DVD he or she does not directly benefit other people using DVDs, however, the effect in the DVD market when new buyers enter is that it strengthens the incentives for movie producers to distribute more movies on DVD thus increasing the number of titles available which benefit all consumers using DVDs.

2.5 The Discussion paper on the application of article 82 of the treaty to exclusionary abuses

The DG Competition Discussion paper on the application of article 82 of the treaty to exclusionary abuses, from here the *Discussion paper*, aims at discussing possible principles for the Commission's application of article 82 EC.²⁴ The Commission here clearly puts the emphasis on a more effect-based approach towards competition analysis. The goal with an effect-based approach would thus be to reduce the risk of false positives²⁵ and false negatives²⁶ with the consequence of enhancing the competition on the market, which would ultimately benefit consumers by providing them with quality products at low prices.²⁷

The Discussion paper is to prevent exclusionary conduct of the dominant firm to limit the remaining competitive constraints on that dominant company, and thereby preventing consumer harm.²⁸ This should, however, not to be seen as protection of competitors of the dominant undertaking, but as preventing the dominant undertaking from distorting the competitive structure on the market and thereby preventing its competitors to compete on the merits.²⁹

The publishing should be seen in the light of the reform of article 82 EC and the previous reforms of article 81 EC and merger control which has been a shift towards a more effects based enforcement approach.

²³ Priest, Jorge L., "Rethinking Antitrust Law in an Age of Network Industries", John M. Olin Center for Studies in Law, Economics, and Public Policy, Research Paper No. 352. p. 3

²⁴ DG Competition, 2005. Discussion paper on the application of article 82 of the treaty to exclusionary abuses. para. 1

²⁵ Condemning a pro-competitive practice in a particular case.

²⁶ Allowing a dominant undertaking to abuse its market power.

²⁷ See, for example, Discussion paper. para. 4.

²⁸ DG Competition, 2005. Discussion paper on the application of article 82 of the treaty to exclusionary abuses. para. 54.

²⁹ Ibid.

3 The purpose and legal standards of article 82

This chapter explains the relevant abuses in context with existing case-law to provide understanding for the interpretation of the legal rules under article 82. It describes the evolution of case-law and some notes from the discussion paper.

3.1 Economic approach to abuses

In the wording of the text under article 82 it clearly states that only those undertakings that “abuse” its dominant position are unlawful. The mere fact that an undertaking is dominant is not in itself an abuse.³⁰ It can, however, be abusive if the dominant undertaking uses its market power on the relevant market to hinder effective competition by allowing it to behave independently of its competitors and customers and ultimately of consumers.³¹

In contrast to article 81 there must be no existence of an appreciable anti-competitive effect under article 82.³² It is enough to show a causal link between the behavior of a dominant undertaking and the mere risk that that behavior could hinder the degree of competition.³³ This interpretation of article 82 has been confirmed several times by the ECJ, most recently in *British Airways*.³⁴

When assessing the anticompetitive effects under article 82 the standard of evidence has evolved to evidence of actual or likely consumer harm.³⁵ The Commission further developed a more economic approach to article 82 when publishing its Discussion paper. The Discussion paper states that “exclusionary conduct which produces actual or likely anti-competitive effects in the market and which can harm consumers in a direct or indirect way” are prohibited by article 82.³⁶

The aim with competition enforcement is thus to protect the competition and not competitors that are less effective.³⁷ Competition on the merits will sometimes harm competitors but benefit consumers. This implies that competition policy

³⁰ Faull, Jonathan & Nikpay, Ali, 2007. *The EC Law of Competition*, Oxford. p 348.

³¹ See, for instance, Case 322/81 *Nederlandse Baden-Industrie Michelin v Commission* (Michelin I), para 30. Also Case 85/76 *Hoffmann La Roche & Co AG v Commission*, para 38.

³² Faull, Jonathan & Nikpay, Ali, 2007. *The EC Law of Competition*, Oxford. p 351.

³³ *Joined Cases 6/73 and 7/73 Commercial Solvents*, para 25. See also, Case 85/76 *Hoffmann La Roche & Co AG v Commission*, para 125.

³⁴ Case C-95/04 *British Airways v Commission*, para 106-107.

³⁵ See, Commission Decision COMP/38.233-Wanadoo Interactive.

³⁶ DG Competition, 2005. Discussion paper on the application of article 82 of the treaty to exclusionary abuses. para 55.

³⁷ Motta, Massimo, 2004. *Competition policy*, Cambridge. p 52.

must be able to identify these pro-competitive conducts and appraise them so they will not become false positives as described in chapter 2.

3.2 Abuses

3.2.1 Exploitative abuses

Exploitative abuses are those that reduce consumer welfare by, for example, generating higher prices and poorer quality of goods, while not directly harming competitors.³⁸ There are some conceptual difficulties when assessing the effects of exploitative abuses. Economic theory predicts that companies with market power operating in that market will charge higher prices or reduce its output to earn super-competitive profits than companies operating in a pure competitive market. This will, of course, reduce the welfare of consumers. However, it is extremely difficult for anti-trust agencies and courts to assess what is the right price or the right output. Because of this the tendency to pursue exploitative abuses is rather low and limits itself to cases where reduction of consumer welfare is particularly clear.³⁹

In the same sense that a dominant undertaking can limit its production it can limit the development of a market or limit the level of technical development within a market. However, one could easily understand the difficulty of determining the appropriate development of a market or the level of technological development within this market. To assess whether consumer have been prejudiced by the dominant undertaking is therefore virtually impossible.

3.2.2 Exclusionary abuses

The exclusionary abuses under article 82(b) are those that limit “the production, markets or the technological development to prejudice of consumers”. This gives us two necessary conditions that the conduct must fulfill to be abusive. First the dominant undertaking must limit production, this can be either limiting competitors output or limiting its own.⁴⁰ The second condition gives us the fact that only output limitation that prejudice consumers are unlawful.⁴¹ It is thus possible for a dominant company to limit its rivals output if no prejudice to consumers results. The obvious problem in this definition is of course; what is

³⁸ Faull, Jonathan & Nikpay, Ali, 2007. *The EC Law of Competition*, Oxford. p. 396 et seq.

³⁹ Op. cit. p 397.

⁴⁰ O’Donoghue, Robert & Padilla, A. Jorge, 2006. *The Law and Economics of article 82 EC*, Portland. p. 197.

⁴¹ Op. cit. p. 198.

“normal competition”?⁴² The discussion paper gives some guidance to how this should be interpreted and suggests that two questions should be asked to see if the conduct is unlawful. First, one has to ask if the undertaking in question is capable of foreclosing competition, and secondly if this foreclosure is market distorting, i.e. have a negative effect on competition to the prejudice of consumers.⁴³ The main problem with the discussion paper is however that it does not distinguish exclusionary conduct that harms competitors from conduct that have pro-competitive effects and therefore should be allowed.⁴⁴

3.3 Refusal to deal

3.3.1 General

The freedom to contract is a deeply buried principle when it comes to doing business between different firms. Generally firms can choose whether they like to enter into contractual relations with one another.⁴⁵ However, there are exceptions to this rule under article 82. One of the main aims has been to force dominant undertakings controlling certain “natural monopolies”, such as harbours, airports etc, to grant access to these institutions in a non discriminatory way.⁴⁶

In the same way the ECJ found that an intermediate product also can be seen as an essential facility, thus forcing the supplier of that product to continue to supply its customers even when the company restructured its production to produce the final product instead.⁴⁷

In Oscar Bronner the Advocate General stated that the primary purpose of article 82 is to prevent distortions of competition – and in particular to safeguard the interests of consumers – rather than to protect the position of particular competitors.⁴⁸

⁴² Case 85/76 Hoffmann La Roche & Co AG v Commission, para 91. For more details see O’Donoghue, Robert & Padilla, A. Jorge, 2006. *The Law and Economics of article 82 EC*, Portland. p 198.

⁴³ DG Competition, 2005. Discussion paper on the application of article 82 of the treaty to exclusionary abuses. para. 58 et seq.

⁴⁴ O’Donoghue, Robert & Padilla, A. Jorge, 2006. *The Law and Economics of article 82 EC*, Portland. p 200-202.

⁴⁵ Op. cit. p. 407.

⁴⁶ See, for instance, C-18/93 Corsica Ferries Italia Srl v Corpo dei Piloti del Porto di Genova Case [1994] ECR I-1783 and Port of Rödby, OJ 1994 L55/52.

⁴⁷ Joined Cases 6/73 and 7/73 Commercial Solvents, [1974] ECR 223

⁴⁸ Opinion of General Advocate Jacobs. Oscar Bronner GmbH & Co. KG v Mediaprint Case C-7/97 [1998] ECR I-07791 para. 58. See also, Discussion Paper para. 210.

3.3.2 The Essential facility doctrine

There have been some interesting cases where the CFI and ECJ have addressed the question whether a dominant holder of a property right has refused third parties access to this right. In *Volvo v Veng* the ECJ found that a refusal by the proprietor of a registered design to grant third parties, even in return of reasonable royalties, a license to the registered design cannot in itself be regarded as an abuse of dominant position.⁴⁹ However, if the dominant undertaking holding the IPR would refuse to supply the parts protected by the specific design which is protected by the IPR, on arbitrary grounds, this would constitute an abuse of dominant position.⁵⁰ It would also constitute an abuse if the dominant undertaking would set prices for the parts on an unfair level, or stop to supply the parts entirely even if a number of cars using those specific parts still are in circulation on the market, provided that such conduct is liable to effect trade between member states.⁵¹

The question arose once again in *Magill* where the ECJ referred to the *Volvo v Veng* case and pronounced that the holder of an IPR refusing to grant a license to a third party not in itself can constitute an abuse.⁵² However, the proprietor of such a right could in *exceptional circumstances* abuse its dominant position.⁵³ The Court established three criteria on which it considered an undertaking to be abusing its dominating position. Firstly, since the undertaking which requested the license, intends to offer a new product for which there is a potential consumer demand, the refusal must be regarded as abusive.⁵⁴ Secondly, there was no objective justification for such a refusal either in the activity of television broadcasting or in that of publishing television magazines.⁵⁵ Thirdly, the dominating companies reserved for themselves the secondary market of television guides by excluding all competition on that market by denying the competitors indispensable information which is necessary to compile such a guide.⁵⁶

Later in *Bronner* a dominant undertaking in the morning newspaper market, who also owned the only nationwide distribution system, was accused by one of its competitors to abuse its dominance by refusing to distribute the smaller newspaper's edition through its distribution system. The question was thus if the refusal to deal in a situation like this, where the smaller undertaking cannot sustain a similar distribution system due to its much smaller turnover, would

⁴⁹ Case 238/87 *Volvo v Veng* para. 11.

⁵⁰ *Op. cit.* para 9.

⁵¹ *ibid*

⁵² Joined cases C-241/91 and C-242/91 *RTE and ITP v Commission* para 49.

⁵³ *Op. cit.* para 50.

⁵⁴ *Op. cit.* para 54.

⁵⁵ *Op. cit.* para 55.

⁵⁶ *Op. cit.* para 56. See also, Joined Cases 6/73 and 7/73 *Commercial Solvents v Commission* para.

constitute an abuse of dominant position.⁵⁷ The Court first notices the three criteria laid down in *Magill*, and explains that even if those were applicable on any property right, the present case would not fulfill those touchstones in an adequate way.⁵⁸ Firstly, the Court notes that there are alternative methods of distributing newspapers, even if those methods are less attractive.⁵⁹ Secondly, there are no economic or legal obstacles making it impossible, or unreasonable difficult, to establish another system of distribution to any other undertaking, by its self or in cooperation with other publishers.⁶⁰ The mere fact that it is economically unrealistic to an undertaking less viable by reasons of a smaller circulation of daily newspapers to establish a distribution system by its own is thus not enough. For such access to be capable of being regarded as indispensable, it would be necessary to show, at the very least, that it would make no economic sense to create a second home delivery system.⁶¹

Finally, in *IMS Health* the ECJ found, with regard to previous case-law, a number of specific circumstances that had to be fulfilled to make the refusal to supply an IPR an abuse under article 82. These provisions are essentially the same as in *Magill*. Firstly, the undertaking requesting the license must have the intent of supplying a new product or service for which there is a potential consumer demand.⁶² The company requesting the license therefore cannot limit itself to essentially duplicating the goods or services already offered by the holder of the IPR.⁶³ Secondly and thirdly are the same as in *Magill* paragraphs 55 and 56.⁶⁴

3.3.3 Consumer welfare analysis with regard to the *essential facility doctrine*

One must first and foremost understand that the criteria laid down in *Magill* and *IMS Health* are only applicable under exceptional circumstances.⁶⁵ The doctrine is not in itself intended to only benefit consumers. However, there are some distinct consumer beneficial attributes as the first criterion laid down in *Magill* states: “the appellant’s refusal to provide basic information [...] thus prevented the appearance of a new product [...] for which there was a potential consumer demand”.⁶⁶ This provision tells us that conduct that ultimately prejudice consumers of new products will be prohibited by article 82, as the criteria in *Magill* are cumulative. The second criterion, the absence of objective justification,

⁵⁷ Case C-7/97 Oscar Bronner GmbH & Co. KG v Mediaprint

⁵⁸ Op. cit. para. 39-42.

⁵⁹ Op. cit. para. 43.

⁶⁰ Op. cit. para. 44.

⁶¹ Op. cit. para. 46.

⁶² Case C-418/01 IMS Health GmbH & Co. OHG v NDC Health GmbH & Co. KG para. 52.

⁶³ Op. cit. 49. See also the AG opinion.

⁶⁴ Op. cit. para. 52.

⁶⁵ See for instance *Magill* para. 50.

⁶⁶ Joined cases C-241/91 and C-242/91 RTE and ITP v Commission para 54.

refers to negative external effects that the mandatory access would cause, such as overuse that would congest the specific facility and thus disrupt its functionality. This would of course also in the end have a negative effect on consumers, even though the primary effect would be to distort the market with regard to the undertakings currently active on that specific market. Neither the third criterion has an absolute effect on consumer welfare. However, one could argue that it would seem plausible that a situation where competition on the secondary market is effectively eliminated the consumer benefits on that market would be lower than if the market was under competition, this is, however, only hypothetical.

3.3.4 Discussion paper on refusal to deal

The Discussion paper considers five conditions that normally have to be fulfilled in order of establish refusal to supply as abusive behavior; (i) the behavior can properly be identified as refusal to supply; (ii) the refusing company is dominant; (iii) the input is indispensable; (iv) the refusal is likely to have a negative effect on competition; (v) the refusal is not objectively justified.⁶⁷ However, when refusing to supply interoperability information protected by IPRs one also has to establish that the refusal to license prevents the development of the market, for which the license is an indispensable input, to the detriment of consumers.⁶⁸

3.4 Tying

3.4.1 General

It is common practice in many markets that the seller of product A ties this to product B and refuses to sell A without the buyer purchasing product B at the same time. Tying by a dominant company can cause both consumer benefits and consumer harm in the market of the tied product, thus creating both pro-competitive and anti-competitive effects.⁶⁹ The conclusion among economists is thus that one need to conduct a thorough investigation to evaluate if tying has an overall negative effect on consumers and welfare in the market of the tied good.⁷⁰

⁶⁷ DG Competition, 2005. Discussion paper on the application of article 82 of the treaty to exclusionary abuses. section 9.2.2

⁶⁸ DG Competition, 2005. Discussion paper on the application of article 82 of the treaty to exclusionary abuses. para. 239.

⁶⁹ O'Donoghue, Robert & Padilla, A. Jorge, 2006. *The Law and Economics of article 82 EC*, Portland, p. 477-480.

⁷⁰ See, for example, Carlton, Dennis & Waldmann Michael, 2002. "The Strategic Use of Tying to Preserve and Create Market Power in Evolving Industries", *The RAND Journal of Economics*, Vol. 33, No. 2. pp. 194-220.

However, it is a complex issue to balance efficiency gains against possible anti-competitive effects.⁷¹

In *Hilti* the Commission found that the dominant undertaking was tying certain consumable products (cartridge strips and nails).⁷² Hilti argued that it was not tying since it was only one product. The Commission, however, argued that there were third-party suppliers in the market for the tied good (nails), but not in the tying good, and that this would be enough to show that there were two distinct products.⁷³

Later in *Tetra Pak II* the Commission once again established that tying of a dominant undertaking had a negative effect on the competitive structure on the relevant market.⁷⁴ Tetra Pak was the dominant producer of both septic and aseptic carton packaging machines and materials required to package liquid food. The Court observed that the Commission correctly held that Tetra Pak's tying of the consumable materials to its packaging machines was targeted at eliminating competition on the market by making its customers totally dependent on Tetra Pak.⁷⁵ Tetra Pak argued that the tying was justified on technical grounds, liability reasons and public health considerations.⁷⁶ The Court, however, referring to *Hilti*, reasoned that it cannot be up to the dominant undertaking to take steps on its own to eliminate products that it regards as dangerous or inferior in quality to its own products.⁷⁷ The Court emphasizes that Tetra Pak could disclose the technical information concerning what type of carton to be used on its systems to ensure that, for example, consumer health would not be compromised. Tetra Pak should therefore disclose the relevant specifications on which packaging cartons would have to meet to be used in its machines.⁷⁸

3.4.2 The Discussion paper on tying

The discussion paper proposes a five stage test to identify “mixed bundle” tying abuses. (i) the company must be dominant in the tying product market; (ii) the tying and the tied goods are two distinct products; (iii) evidence of coercion of

⁷¹ O'Donoghue, Robert & Padilla, A. Jorge, 2006. *The Law and Economics of article 82 EC*, Portland. p. 491.

⁷² Decision 88/113/EEC [1988] OJ L65/19 (*Hilti*)

⁷³ Case T-30/89 *Hilti AG v Commission* [1991] ECR II-1439 para. 68. The ECJ upheld the CFI's ruling. See Case C-53/92P *Hilti AG v Commission* [1994] ECR I-667

⁷⁴ Case C-333/94P *Tetra Pak v Commission* [1996] ECR I-5951

⁷⁵ Case T-83/91 *Tetra Pak International SA v Commission (Tetra Pak II)* [1994] ECR II-755 para. 135. Later upheld by ECJ. See, case C-333/94P *Tetra Pak International SA v Commission (Tetra Pak II)* [1996] ECR I-5951

⁷⁶ Case T-83/91 *Tetra Pak International SA v Commission (Tetra Pak II)* [1994] ECR II-755 para. 126-133

⁷⁷ Op. cit. para. 138

⁷⁸ Op. cit. para. 139

consumers (iv) the tying practice is likely to have a market distorting effect; (v) the tying practices is not justified objectively or by efficiencies.⁷⁹

In regard to the plotline of this essay the third criterion is of particular interest. The Discussion paper recognizes that the fact that consumers are coerced to the dominant undertaking is a matter of the size of the bundle discount. If the dominant undertaking offers a bundle and the price consumers have to pay to obtain this bundle covers the company's long run incremental costs (LRIC) for the same, then their cannot be abusing tying except in exceptional circumstances.⁸⁰ This is because this type of competition would not exclude an equally efficient competitor only providing one of the products in the bundle. The concept can be seen as a *strict* rule of reason which provides dominant undertakings with guidance when assessing their price policies, thus providing more predictable legal implementation.⁸¹

The Discussion paper opens up a wider perspective of efficiency defense for possible abuses under article 82. The Commission suggests that it is up to the dominant company to show that the efficiencies invoked against the alleged abuse are of greater good to consumers and competition than the infringement of article 82.⁸²

3.4.3 The Rule of Reason

As said earlier it is extremely difficult to predict consequences of tying. But just because it is hard one must not lean on *per se* rules, but instead analyze the tying practice in the light of sound economic principles. One could identify two alternative approaches to the rule of reason. Firstly, one could identify an unstructured rule of reason; second, one could identify a more structural rule of reason where the first starts at the presumption that the tying practice has no anticompetitive effects and the second sets up a number of screens which the tying arrangement must pass.⁸³ Among many others, O'Donoghue and Padilla suggest that the prosecution (Commission) should bear the burden of proof in the first two screens and that the burden be divided by the parties in the final

⁷⁹ DG Competition, 2005. Discussion paper on the application of article 82 of the treaty to exclusionary abuses. para. 183-203 See also, O'Donoghue, Robert & Padilla, A. Jorge, 2006. *The Law and Economics of article 82 EC*, Portland. p. 506-507

⁸⁰ DG Competition, 2005. Discussion paper on the application of article 82 of the treaty to exclusionary abuses. para. 190.

⁸¹ O'Donoghue, Robert & Padilla, A. Jorge, 2006. *The Law and Economics of article 82 EC*, Portland. p. 507.

⁸² DG Competition, 2005. Discussion paper on the application of article 82 of the treaty to exclusionary abuses . para. 77.

⁸³ O'Donoghue, Robert & Padilla, A. Jorge, 2006. *The Law and Economics of article 82 EC*, Portland. p. 512-517.

efficiency-screen.⁸⁴ In the first screen seven characteristics for tying to have an abusive effect are analyzed, where each must be satisfied or it will not be abusive tying; (i) Market power of the dominant firm; (ii) imperfect competition in the tied market (due to fixed costs); (iii) commitment to tie; (iv) competitors' inability to match the tie; (v) likelihood of competitor exit; (vi) entry barriers; (vii) absence of buyer power. The next screen analyses the tying practice effect on competition by positing a theory on how the tying practice will lead to anticompetitive effects, and to evaluate that theory with regard to factual circumstances in the present case.⁸⁵ The third screen puts efficiencies associated with the tie in contrast to the negative effects on competition and consumers. Only if a tying practice passes these three steps the tying should be considered abusive.

⁸⁴ O'Donoghue, Robert & Padilla, A. Jorge, 2006. *The Law and Economics of article 82 EC*, Portland. p. 512.

⁸⁵ Op. cit. p. 516.

4 The CFI in *Microsoft*

In this chapter I will present the essentials of Microsoft's, the Commission's and the Court's argumentation to give the reader an understanding of the case. This will then be used in the following chapter in conjunction with the previous chapters to understand the positive and negative aspects of the judgment.

4.1 General

In the CFI judgment *Microsoft* the term *consumer* is used 134 times.⁸⁶ This implies to some extent what type of orientation the Commission has used during the investigation which preceded the trial. The fact that both the Commission decision and the judgment from the CFI are very comprehensive also indicates that a much more thorough examination on the specifics regarding the abuses currently established by the CFI.

4.2 Refusal to supply interoperability information

4.2.1 Indispensible interoperability information

The Court sets out in paragraph 229 that an undertaking in Microsoft's position not by itself constitutes an obligation to supply its competitors with interoperability information. However, if the Court would determine that such information would be vital to Microsoft's competitors to remain viable on the work group server market, it would follow that the maintenance of effective competition on that market would be distorted.⁸⁷

4.2.2 The product

Microsoft, relying on the definition set out in *Magill* and *IMS Health*, mainly argues that, the Commission in the contested decision fails to identify any new potential products that Microsoft's competitors might seek to develop using the interoperability information requested. The Commission, thus, also fails to demonstrate that there is a potential consumer demand for those products.⁸⁸ In *Magill* the undertaking requesting the protected information was seeking to develop a new product, a television guide, for which there was a consumer demand. The dominant undertakings in question were thus deliberately preventing the development of a superior product. Therefore, Microsoft claims that the

⁸⁶ Case T-201/04 Microsoft Corporation v. Commission [2007]

⁸⁷ Op. cit. para. 229. See also, for example, *Michelin v Commission (Michelin I)*.

⁸⁸ Case T-201/04 Microsoft Corporation v. Commission [2007] para. 624.

Commission have failed to apply the “new-product-test” set out in *Magill* and later confirmed in *IMS Health*, to the advantage of a new test, a balancing of incentives to innovate test, which is outside the scope of the settled case-law.⁸⁹

The Court, however, disagrees and confirms the Commissions interpretation of the *IMS Health* judgment relating to the Advocate General’s opinion which states that where there are two opposing interests one needs to balance those against one another. When balancing the protection of an IPR and the economic freedom of its holder against the interest in protecting free competition, the later can prevail only where refusal to license prevents the development of the secondary market, to the detriment of consumers.⁹⁰ The Court holds that the circumstances relating to the appearance of a new product cannot be the only consideration which may prejudice consumers due to the refusal to license an IPR.⁹¹

The Court further emphasize that the *lock-in effect* the customers experience as a result of the lack of interoperability between the different Windows OSs and competing undertakings Server OSs is all the more damaging to consumers as they attach great importance to several features provided by Microsoft’s competitors.⁹² Because of this *lock-in effect* Microsoft’s competitors find it discouraging to innovate and market server OS which would have benefited consumers, and as a result the competition on the server OS market is distorted, which ultimately prejudice consumers.⁹³

4.2.3 Objective justifications

Microsoft claims that the refusal to supply was objectively justified by the fact that the information in question was protected by IPRs and the disclosure would harm Microsoft’s incentives to invent.⁹⁴ The new balancing test provides dominant firms with a lot of legal uncertainty since it is virtually impossible by such an undertaking to assess whether preserving incentives to innovate can justify a decision to retain their intellectual property for their own use.⁹⁵

The Commission holds that the mere fact that the property concerned is protected by an IPR cannot institute an objective justification as explained in *Magill* and *IMS Health*. The Court concurs with the Commission’s analysis and explains that a refusal to license an IPR could never be considered to constitute an infringement

⁸⁹ Case T-201/04 Microsoft Corporation v. Commission [2007] para. 621-628.

⁹⁰ Case C-418/01 IMS Health GmbH & Co. OHG v NDC Health GmbH & Co. KG para. 49. See also the AG opinion. para 62. And Case Microsoft Corporation v Commission para. 646.

⁹¹ Case T-201/04 Microsoft Corporation v. Commission [2007] para. 647.

⁹² Op. cit. para. 407-412 and 650-652.

⁹³ Op. cit. para. 653.

⁹⁴ Op. cit. para. 666-668.

⁹⁵ Op. cit. para. 670-671.

of article 82 if the ownership associated with that right in itself were to be an objective justification. It would be contrary to the ECJ's statements in both *Magill* and *IMS Health* to come that conclusion.⁹⁶

In regard to the issue of the new balancing test the Court finds that the Commission came to the conclusion that Microsoft's incentives to innovate does not outweigh the exceptional circumstances found at hand in the present case. Neither do Microsoft's incentives to innovate outweigh the positive impact of disclosure to the industry as a whole. However, these findings was not due to a new balancing test but to the fact that the Commission refuted Microsoft's concerns relating to the fear of Microsoft's products might be cloned.⁹⁷

4.3 Tying of Windows Media Player

The Commission argues that four conditions must be fulfilled in the present case to establish abusive tying. These are; (i) the tying and the tied product are two separate products; (ii) the undertaking concerned is dominant in the tying market; (iii) the undertaking concerned does not give the customers an opportunity to attain the tying product without the tied product; (iv) the practice in question forecloses competition.⁹⁸ Microsoft does not dispute its dominant position in the tying product.⁹⁹

4.3.1 Two separate products

Microsoft argues that a product should primarily be defined by consumer expectations and demand, and that consumers in reality want media functionality in their operating systems.¹⁰⁰ Microsoft also notice that the lack of demand for Windows XPN¹⁰¹ suggest that the market identifies the two products as one.¹⁰² Microsoft also points out, in contrast to *Hilti* and *Tetra Pak II*, that the Commission failed to establish that there was a demand for the tying product without the tied product.¹⁰³

First, the Court notes that the markets in the IT industry are under rapid technological change and that what are two separate products today may be regarded as one tomorrow, both from a technological aspect and from the aspect

⁹⁶ Case T-201/04 Microsoft Corporation v. Commission [2007] para. 690-693

⁹⁷ Op. cit. para. 709.

⁹⁸ Op. cit. para. 852.

⁹⁹ Op. cit. para. 854.

¹⁰⁰ Op. cit. para. 890.

¹⁰¹ The XPN OS was brought to the market as a consequence of the commission's decision in 2004, where N stands for "*No media functionality*".

¹⁰² Case T-201/04 Microsoft Corporation v. Commission [2007] para. 891.

¹⁰³ Op. cit. para. 892.

of the competition rules.¹⁰⁴ However, the definitions found in the case-law support the Commissions analysis. In *Hilti*, for example, the Court found that nails and nail magazines were two separate products, but one could easily reckon that there would be no demand for nail magazines without nails. Microsoft's argument that complementary products cannot constitute separate products under article 82 is therefore contradictory to Community case-law.¹⁰⁵ The Court states that it is possible that consumers wish to acquire an operating system with application-software pre-installed but from different suppliers. Microsoft therefore ignores the role played by OEMs when assessing whether consumers wish to have WMP pre-installed in Windows OS.¹⁰⁶ The fact that there are several companies in the streaming media player market, which have streaming media players as their only product, also constitutes strong evidence of separate products as explained in both *Hilti* and *Tetra Pak II*.¹⁰⁷

4.3.2 Evidence of consumer coercion

Microsoft argues, in contrast to *Hoffmann-La Roche* and *Hilti*, that it does not impose any financial disadvantages that would discourage consumers from using competitors' products, and consumers are not required to pay anything extra for the media functionality in Windows OS.¹⁰⁸ Since the United States Settlement no one is required to use middleware associated with Windows OS such as WMP, it is thus possible to remove all end-user access to that functionality in favor of competing media players.¹⁰⁹ Last, Microsoft puts forward the fact that consumers, unlike *Tetra Pak II* and *Hilti*, are free to install third-party media players, and those consumers on average use 1.7 media players each month.¹¹⁰

The Court, however, concludes the fact that Windows OS cannot be obtained without WMP must be seen as a coercion of supplementary obligations on the subject to contract.¹¹¹ It also notes that the coercion of supplementary obligations is not only of contractual nature, but also technical, as it was impossible to uninstall WMP.¹¹² In regard to the question that Microsoft does not charge anything extra for the tied product the costs of WMP, as evident from paragraph 232 of Microsoft's application, is included in the total price of Windows OS.¹¹³ Second, the Court notes that neither in article 82(d) or in the case-law on bundling

¹⁰⁴ Case T-201/04 Microsoft Corporation v. Commission [2007] para. 913.

¹⁰⁵ Op. cit. para. 920.

¹⁰⁶ Op. cit. para. 922-923.

¹⁰⁷ Op. cit. para. 927.

¹⁰⁸ Op. cit. para. 951.

¹⁰⁹ Op. cit. para. 952.

¹¹⁰ Op. cit. para. 953.

¹¹¹ Op. cit. para. 961.

¹¹² Op. cit. para. 963.

¹¹³ Op. cit. para. 968.

consumers must pay a price for it to be regarded as abusive tying.¹¹⁴ In regard to the use of WMP the fact that consumers may install different media players the Court notes that the Commission was right when it stated that consumers must not be forced to use the tied product or prevented from using a similar product supplied by a competitor for the tying to be abusive.¹¹⁵ The Court notes that Microsoft's argument relating to the United States Settlement cannot be accepted as the abuse started 1999 and was not terminated until September 2002.¹¹⁶

4.3.3 The foreclosure of competition

Microsoft essentially challenges the Commission's theory based on indirect network effects and that competition may be foreclosed at some unidentified point sometime in the future because of third parties incentives to design and develop products solely for WMP.¹¹⁷ Microsoft thus questions the Commission's presumption that anti-competitive effects exist because of third parties future conduct over which Microsoft has no control.¹¹⁸ In regard to the outcome of the United States case, Microsoft ensures that all necessary steps have been taken to guarantee the ability for competing companies to integrate their functionalities, such as media players, in Windows OS.¹¹⁹ It goes on essentially arguing that there is virile competition on the market for streaming media players and that OEMs are free to install competing media players.¹²⁰

When the Commission asserted that the distribution of additional media formats was subject to additional costs Microsoft argues that the Commission has failed to show that these costs outweigh the benefits of distributing a second or third format.¹²¹ Microsoft also argues that the tipping effect in the media player market only would be possible if two conditions were fulfilled; (i) users and content providers faced significant costs if they used multiple media players; (ii) media players were perceived as homogenous with respect to their instinct characteristics and the content accessible by such media player.¹²² None of these conditions are according to Microsoft fulfilled in the present case.

The Court, however, considers Microsoft's arguments unfounded and based on a misinterpretation of the decision.¹²³ The Court finds that the tying of WMP from

¹¹⁴ Case T-201/04 Microsoft Corporation v. Commission [2007] para. 969.

¹¹⁵ Op. cit. para. 970.

¹¹⁶ Op. cit. para. 973.

¹¹⁷ Op. cit. para. 990.

¹¹⁸ Ibid.

¹¹⁹ Op. cit. para. 991-993.

¹²⁰ Op. cit. para. 993-998.

¹²¹ Op. cit. para. 999-1000.

¹²² Op. cit. para. 1002.

¹²³ Op. cit. para. 1033.

1999 and the fact that WMP could not be removed from the operating system had the effect of foreclosing competition.¹²⁴ As WMP was tied with Windows OSs the media player enjoyed an extremely beneficial situation to the detriment of other operators on the streaming media player market. The fact that WMP had almost the same market penetration as the Windows OS clearly suggests this.¹²⁵ The Court also notes that consumers who obtain Windows OS with WMP integrated are less likely to use alternative media players which strengthen Microsoft's position to the prejudice of its competitors.¹²⁶ It is also likely that OEMs would be reluctant to install a second media player as this would make the bundle more expensive and therefore less attractive for consumers.¹²⁷ The Court also agrees with the Commission that there are other ways to distribute WMP than to integrate it in the Windows OS.¹²⁸ The Court therefore finds that there has been foreclosure of competition on the relevant market and that the Commission's findings are sound and well established.¹²⁹

4.3.4 Objective justifications

Microsoft argues that the software industry as a whole benefits from WMP being integrated in Windows OSs.¹³⁰ The main justification brought forward by Microsoft is that the integration of WMP is a response to technological advances in the operating systems business and thus a response to a changed consumer demand.¹³¹ The integration of WMP is so widely spread in the software development business that software developers program often uses the media functionality in Windows OS to benefit their own software. The removal of WMP would thus render some software applications on the market useless.¹³² Microsoft also claims that the Commission has failed to analyze the consumer benefits associated with the tying practice.¹³³

The Court, however, does not question Microsoft's business model of offering a bundle of Windows OS and WMP, it merely questions the tying practice which does not allow consumers to obtain a Windows without WMP.¹³⁴ The Court goes on arguing that Microsoft cannot justify its behavior by relying on the fact that its behavior have a positive effect on development in secondary markets when the

¹²⁴ Case T-201/04 Microsoft Corporation v. Commission [2007] para. 1036.

¹²⁵ Op. cit. para. 1038-1039.

¹²⁶ Op. cit. para. 1041-1042.

¹²⁷ Op. cit. para. 1045.

¹²⁸ Op. cit. para. 1053.

¹²⁹ Op. cit. para. 1058.

¹³⁰ Op. cit. para. 1102-1107.

¹³¹ Op. cit. para. 1108.

¹³² Op. cit. para. 1109-1115.

¹³³ Op. cit. para. 1116.

¹³⁴ Op. cit. para. 1149-1150.

most obvious effect is foreclosure of competition on the streaming media player market.¹³⁵ The benefits of integrating WMP in Windows OS could be achieved without the tying practice and thus not harm the competition on the relevant market.¹³⁶ The Court thus dismisses Microsoft's justifications as unfounded and irrelevant to the question of foreclosing competition.

¹³⁵ Case T-201/04 Microsoft Corporation v. Commission [2007] para. 1151-1153.

¹³⁶ Op. cit. para. 1156.

5 Consumer Welfare Analysis in *Microsoft*

In this chapter I will analyze the *Microsoft* case with regard to the facts borne form chapters 2-4.

5.1 Refusal to supply

Microsoft's behavior in the server operating system market and the PC operating system market is an excellent economic example of how a dominant firm can exploit its market power in one market (PC operating system market) to leverage this into the neighboring market (Server operating system market). This is clear from Microsoft's strategy when it entered the Server operating system market. First, Microsoft discloses interoperability information to its competitors which in turn increases the value of Windows PC OS (and Windows Server OS) to consumers and thus increases the entry barriers to the PC operating system market, which in turn strengthens Microsoft's market power in that market. As Microsoft's market share increases on the Server operating system market Microsoft decreases the disclosure of interoperability information, thus making competitors products inferior in regard to functionality with Microsoft NT Server and Windows PC OSs. This effect consumer purchase behavior to the extent that they fear that the only way to maintain a functional network structure is to obtain an all Microsoft solution even if they regard competing products as superior, the so called *lock-in* effect. The market for server operating system will most certainly tip in favor of the dominant company thus excluding all competition on the relevant market and strengthen the dominance in both markets even more.

The extensive investigation committed by the Commission substantiates this interpretation of Microsoft's behavior, thus establish a refusal to supply interoperability information to the detriment of consumers. The question here is whether the previous case-law analysis described above in section 3.3 is applicable to *Microsoft* and what consequences it might have to future cases.

There are some possible problems with the *Magill* test, especially with regard to the new product criterion, which needs to be analyzed in more detail. The ECJ has been clear in its analysis in *Magill* and *IMS Health* that for a refusal to disclose material protected by IPRs the dominant company must be preventing the development of a new product, and that the undertaking seeking the information must show that it intends to develop such new products that will benefit consumers on the relevant market. In *Microsoft*, however, the Commission has put this criterion aside in favor of an analysis of what would benefit the market the most in terms of incentives to innovate. The Commission concludes that the disclosure of the interoperability information in present case would have a

positive effect on innovation in the whole of the server operating system market and that this disclosure would not offset Microsoft's own incentives to innovate. This is further established by the Court at paragraph 701 to the judgment. The Court concludes that the Commission was right when it expanded the interpretation of a 'new product' to also involve follow on innovations which would provide the market with a new product in the future.

One must argue that the new balancing test of incentives to innovate is sounder than the new product criterion laid down in the case-law. The obvious problem with the new-product-test is that it first must be shown that there is a potential consumer demand for the proposed new product, and secondly one cannot be sure that the information that has to be disclosed is intended to develop new products, and thirdly one must decide what is a new product and what is a mere clone. How can one, for example, prove that a market will appraise a certain product before the market has evaluated the product? The criterion of a new product is drawn from *Magill* where the undertaking seeking the information protected by IPRs first had published its extensive TV-guide, but had to stop the distribution because the dominant firms holding the IPRs sued Magill in a national Court for infringement of their copyright. It was thus in this case established that there was a consumer demand because the product had already been published on the market. It is therefore a bad proxy to determine whether consumers will be better off by disclosing the information in regard to the possible development of a new product. It is much easier to determine and balance the incentives to innovate for the dominant undertaking and the industry as a whole. And because innovation is a good proxy for consumer welfare the possibility for enforcement authorities to make correct decisions in competition cases thus increase.

However, there are also some distinct drawbacks to the incentives-balance-test. As Microsoft correctly observes at paragraph 671 to the judgment this test makes it hard for dominant companies to know when it is ok to retain an IPR for its own use and when this conduct can become an infringement of article 82. This legal uncertainty will without any doubt have a negative effect on dominant undertakings incentives to invest in R&D. This is one issue that I find disturbing in the judgment and it is thus unfortunate that Microsoft did not appeal to the ECJ and perhaps get more clarity on the exact definitions and thus provide the Community with more legal certainty.

The question that remains to be answered is thus what value one should put in this part of the judgment? Because of Microsoft's quasi-monopoly on the PC operating system market one could hope that this case is an *extreme* exceptional circumstance and that the incentives-balance-test will be defined in greater detail to thus give more guidance to a specific undertaking operating in a specific market. Another objection to the new test is the question whether one should

analyze the long-run effects or the short-run effects. One could argue that the aim of the Commission's enforcement policy is rather emphasized on short term effects and that approach would of course give a positive effect to innovation in the industry if Microsoft was to disclose its interoperability information. However, the more one extend the scope in time, the smaller the positive effect will be and the stronger the negative effect that Microsoft points out will be. It is thus unfortunate that the Court did not explain this in greater detail. The Commission must therefore not ignore the long run effects when analyzing anti-competitive behavior under article 82.

The judgment has broadened the scope of when dominant undertakings possibly have infringed article 82 but have not given us any real landmarks to evaluate specific undertakings which could be seen as abusive. A central issue is thus the need for legal certainty in industries operating in fast developing market and markets characterized by network externalities.

5.2 Tying of Windows Media Player

There are some interesting considerations in the tying part of the judgment. Firstly, one must note, as the Court does in paragraph 1145 to the judgment, that the Commission has the burden of proof for all parts of the tying criteria but those arguments of objective justifications that are borne by Microsoft. It is thus the Commission who has the burden of analyzing the possible abusive conduct in every possible aspect to determine whether it has a negative impact on the market to the detriment of consumers. Secondly, one must identify the scope of the Court's argumentation.

It is obvious that one could distinguish WMP as a separate product from Windows OSs if one applied the *Hilti* definition since there are independent producers of the tied good and there is a consumer demand for streaming media players separated from the demand on operating systems. However, there are also some distinct differences such as the speed of development on the relevant market, where the development on the software industry markets is far more rapid than the market described in *Hilti*. Another difference is the presence of network externalities which essentially benefits consumers and developers in downstream markets. It is clear from the Commission's argumentation that software developers prefer, or in the future will prefer, to develop applications and other technologies based on Windows Media Technology because of the reach WMP has to consumers. It is thus likely that consumers will find it attractive to obtain WMP with Windows OS because the fact that developers of streaming media etc. will favor Windows media formats when developing applications and internet-based material, and this enables consumers to more easily utilize media content on the internet and applications integrating with Windows Media Technology. Consumers benefit

from network effects, and the provider of the good also benefit from those effects, however, this is of course to detriment of competitors and sometimes to the competitive structure of the market. The Court's main task would thus be to balance the consumer benefits associated with the tying practice with the possible negative effects of foreclosure in the relevant market. Only when the negative effects clearly outweigh the positive effects one could argue that the tying practice should be prohibited.

However, the Commission point out several characteristics of Microsoft's tying practice that ought to have a negative effect on both consumers and the competitive structure on the relevant market. As both the Commission and the Court points out, it was not possible to obtain Windows OSs without WMP, and it was not even possible to remove it. The latter, the US settlement dealt with, and as a consequence all middleware is now possible to remove from Windows OSs. The question would thus be if the fact that consumers cannot choose to obtain Windows OSs without WMP can be seen as; (i) consumer coercion; (ii) foreclosure of competition. First, as the Court correctly observes in paragraph 962 to 965 to the judgment, consumers and OEMs could not obtain Windows OSs without WMP. If applying the coercion criterion from *Hilti* and *Tetra Pak II* one must find that the tying of WMP is made subject to supplementary obligations because of the fact that consumers may not choose to buy Windows OSs without WMP. Second, that Microsoft's tying practice forecloses competition on the relevant market must be seen in the light of the analysis of the network effects above. It is true as the Court recognize that Microsoft's implementation of WMP in Windows OSs made it impossible to override or remove WMP from the operating system. However, this issue the US settlement covered and the need to punish Microsoft in Europe as well thus unnecessary. It should however be clear that the irreversible integration of WMP in Windows OSs clearly had the effect, as the Commission and the CFI stated, to hinder competition to the detriment of consumers. The question in this matter is thus whether Microsoft's refusal to provide an untied version of Windows had the effect of foreclosing competition on the relevant market. The Court is very specific in its judgment and points out the obvious that a tying Windows containing WMP will have a negative effect on competitors' sales of streaming media players, thus concluding that Microsoft's conduct on this point is abusive.

This is, so far as I can see, an unfortunate approach to tying abuses and not a sound policy to competition enforcement. The Court is applying a disguised *per se* approach which it tries to make one believe is a *rule of reason* oriented approach. The Court reasons as the five stage test established in previous chapter must be fulfilled, (i) the tying and the tied product are two separate products; (ii) the undertaking concerned is dominant in the tying market; (iii) the undertaking concerned does not give the customers an opportunity to attain the tying product

without the tied product; (iv) the practice in question forecloses competition; (v) the absence of objective justifications. It is thus Microsoft who has the burden of proof that efficiencies cannot be achieved by less efficient means, and that these efficiencies outweigh any anticompetitive effects. This is not a rule of reason approach in the aspect that the Court places the burden of proof to demonstrate that the pro-competitive effects outweigh the anticompetitive effects on Microsoft solely. As described in chapter 2 it is virtually impossible to calculate the benefits rising from network effects and thus impossible for Microsoft to prove that these effects are stronger than the anti-competitive.

The Commission and the Court have also failed to correctly analyze the effects on the market with regard to entry and exit barriers. The Court concludes in paragraph 1088 to the judgment that the tying increases barriers to entry to the streaming media player market. This is not at all substantiated by neither the Commission or the Court itself, the fact is that entry to software markets is rather linked to new solutions developed by young inventors on their own without big software companies. There are neither any substantial costs, as the Commission states, to enter the software market as can be seen in the number of hobby-programmers etc. The numbers of media players available today are even more than when the Commission started its investigation seven years ago, and still almost all Windows OSs are shipped with WMP preinstalled. The competition is thus still virile on the market even if 90 % of the consumers have access to WMP. The Commission was thus wrong when it predicted that the market would tip in favor of WMP.

To sum up the previous analysis we find that the Court has successfully applied the criteria laid down in *Hilti* and *Tetra Pak II* to the present case, and found an infringement of article 82. The disconcerting part is however that we see no indications of market failure. The Commission has only concluded that tying *could* have a negative effect on competitors' sales in the future.

But if the Commission would have been right and the market would have tipped or would tip in the future, would this be detrimental to consumer welfare? The answer is no, probably not. This is because of the presence of network externalities. It seems that the Commission and the Court argue that, since we cannot measure the exact effect of network externalities, they are not that strong. The Court's interpretation of network effects is based on an anti-competitive approach i.e. that network externalities has a negative impact on competition and therefore a negative impact on consumer welfare. But as already discussed, this is not true network effects have a very strong positive effect on consumer welfare, thus we must conclude that the judgment is wrong in the part regarding the tying practice.

6 Conclusions

The Commission analysis of Microsoft's behavior with regard to the refusal to supply interoperability information is sound and the Court's judgment thus sound. However, I have showed that this judgment can have a negative effect on the incentives for dominant undertakings to invest in R&D and competing on the merits. This is essentially because the Commission's new incentives to innovate balance test, which in essence is a much sounder alignment to competition enforcement than the old new-product-test established in *Magill*, but in its present form gives no guidance to competing companies which creates a substantial amount of legal uncertainty.

In the part regarding the tying of WMP to Windows OSs I have shown that the Court successfully, and in a reasonable way, applied the existing case-law to the present case. However, I have also shown that there are significant differences between present case and previous case-law. The most prominent would be the existence of network externalities which the Commission and the Court have failed to correctly analyze in regard to the consumer welfare standard. I also conclude that the Court places the burden of proving the benefits of the undertaking solely on Microsoft. This is unfortunate and not a rule of reason since the Court failed to correctly determine the positive impact the undertaking had on consumers.

In writing this essay many questions have emerged. It is clear that European enforcement authorities and Courts have not understood the scale of network externalities and that these effects often provides huge consumer benefits. Thus, more research must be done to establish new rules to old abuses in industries with strong network effects, especially in fast growing IT-technology industries.

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