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Tying as Abuse of Article 82 (d)
of the EC Treaty –
A Study of the Microsoft Case

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Summary

On 24 March 2004, the European Commission found Microsoft Corporation guilty of violating Article 82 of the EC Treaty.¹ The Commission established two separate violations of the provision. However, the relevant abuse in relation to this thesis was the finding of illegal tying by technical integration of Windows Media Player in Windows Client PC Operating System in a manner inconsistent with Article 82 (d) EC:

‘Any abuse by one or more undertakings of a dominant position within the common market or in a substantial part of it shall be prohibited as incompatible with the common market insofar as it may affect trade between Member States.

Such abuse may, in particular, consist in:

[...]

(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.’

In its Decision, the Commission applied four elements to determine whether tying was abusive. The first condition was that the company concerned had to be in a dominant position in the tying market. The Commission concluded that since Microsoft’s market share in the market for client PC operating systems was over 90%, the company was overwhelmingly dominant in this market. A second element of abusive tying was that the tying product (Windows) and the tied product (WMP) had to be separate products. The Commission employed the consumer demand test and considered the existence of vendors who developed and supplied media players separately as evidence of a separate market. In addition, separate distribution of the two products, different functionalities and the character of the industry structures enhanced this view. The third criterion presented by the Commission was unavailability of untied supply. In its Decision, the Commission established that Microsoft did not supply any untied version of Windows nor did it provide any ready technical means of removing the media player from the operating system. Finally, what differentiated *Microsoft* from earlier case law was the fourth element of abusive tying – a foreclosure effect on the tied market. In view of the fact that Microsoft was overwhelmingly dominant in the market for client PC operating systems, a guaranteed and exclusive distribution method was afforded WMP. In its Decision, the Commission examined the distribution channels available in the media player market and established that there was no equally effective method of distributing media players as the one controlled by Microsoft. In addition, as a result of the indirect network effects produced by Microsoft’s behaviour, high barriers to entry were produced. The majority of content providers, developers and end-users had begun to rely on WMP format

¹ Consolidated version of the Treaty establishing the European Community, OJ C 325, 24.12.2002.

since Microsoft's tying arrangement guaranteed that WMP was as ubiquitous on the market as Windows. As a consequence, Microsoft attained an exceptionally advantageous position in the market for media players. This position was not a result of the merits of Microsoft's media player but instead an effect of the tying arrangement employed by the company. Considering these factors, the Commission concluded that Microsoft had indeed infringed Article 82 (d) by technically integrating WMP with Windows. Thus, along with a €497 million fine, the Commission ordered Microsoft to supply a full-functioning untied version of Windows.

In essence, the Decision presents a shift in the structure of analysis in tying cases. Prior to *Microsoft*, a form-based approach was applied as tying was prohibited *per se*. In contrast, the Commission's reasoning in *Microsoft* represents a more effects-based analysis since the foreclosure effect of the tie was a key element in the assessment. However, not everyone agree on the altered legal status of tying in EC competition law. While the Commission argues that it balanced the anti-competitive effects and the pro-competitive benefits of the tie in a manner similar to the US 'rule of reason' approach, others dismiss the Commission's approach as a modified *per se* illegality test.

Other aspects of the case have also produced deviating opinions, for example, the effects on innovation and whether the Decision protects single competitors rather than competition as a means of enhancing consumer welfare. Criticism against the Decision has focused on the use of the consumer demand test, the standard and burden of proof applied by the Commission, in addition to the lack of guidance in relation to the concept of 'competition on the merits'.

While *Microsoft* demonstrates a new position concerning the assessment of abusive tying, the case does not display an altered position concerning the illegality of abusive tying. The Commission's approach as portrayed by the high evidentiary requirements on the dominant undertaking reflects a continued suspicious attitude towards tying. In addition, the economic aspects of tying remain underdeveloped in EC competition law. Thus, in my view, it was the method of assessing the tie that was flawed in *Microsoft*, not necessarily the conclusion.

Preface

Thank You.

My family and friends, for your constant *love* and *support*.

My *supporting Love*, for your *humour* and endless *patience*.

My *patient* and *humorous* supervisor, Henrik Norinder, for invaluable guidance in the process of writing this thesis.

Abbreviations

ABA	American Bar Association
API	Application Programming Interface
Article 82 EC	Article 82 of the EC Treaty
CFI	Court of First Instance
DG	Directorate General
EC	European Community
ECJ	European Court of Justice
EC Treaty	Consolidated version of the Treaty establishing the European Community, OJ C 325, 24.12.2002
Microsoft	Microsoft Corporation
<i>Microsoft</i>	Case COMP/C-3/37.792 <i>Microsoft</i>
OEM	Original Equipment Manufacturer
Para(s)	Paragraph(s)
PC	Personal Computer
The Decision	The Commission's decision in Case COMP/C-3/37.792 <i>Microsoft</i>
US	United States
Windows	Windows Client PC Operating System
WMP	Windows Media Player

1 Introduction

On 24 March 2004, following a five-year investigation, the European Commission fined Microsoft Corporation (Microsoft) € 497 million for two separate violations of Article 82 (ex Article 86) of the EC Treaty (EC).² The Article regulates the situation where one or more companies in a dominant position abuse their market power. The purpose of this provision is not to prohibit market power *per se* but to control it by not tolerating abuse of the same. Article 82 provides four examples of abuse but the list is not exhaustive. The first abuse found by the Commission was a refusal on Microsoft's part to supply inter-operability information, which according to the Commission was contrary to Article 82 (b).³ However, the relevant abuse in relation to this thesis was the Commission's finding of illegal tying. Subparagraph (d) of Article 82 describes tying as '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.'

In its decision (the Decision),⁴ the Commission concluded that Microsoft had illegally tied Windows Media Player (WMP) to Windows Client PC Operating System (Windows) since there was no version of Windows available on the market that did not incorporate the WMP. Nor was there any ready technical means of removing the media player from Windows. Since Microsoft had a market share of over 90% in the market for client PC operating systems, this ensured a guaranteed and exclusive distribution method for the WMP - a method only accessible to Microsoft. The company thus obtained an extremely advantageous position in the market for media players, unrelated to the merits of the media player. In view of these facts, the Commission found that the company was in a position to weaken effective competition in the market for the supply of media players. Thus, along with the €497 million fine, the Commission ordered Microsoft to offer a full-functioning version of Windows that did not incorporate the WMP.

Microsoft is a unique case in many aspects; it was the first decision relating to tying by means of technical integration; it introduced a new approach towards tying that included an assessment of its foreclosure effect; and the fine was the highest ever decided in EC history.

Still, while the EC case law regarding tying is scarce, the phenomenon is not. Instead, tying is widely used throughout our economy: shoes come with laces, cars are delivered with steering wheels and earrings are sold in pairs. In fact, most products on today's market can be divided into smaller components that can be sold separately. This leads to a conclusion that some find worrying; if the Commission found Microsoft guilty of tying its media player with Windows, why then should other software applications that are

² Article 54 of the Agreement on the European Economic Area (EEA) was also infringed.

³ Article 82 (b): 'limiting production, markets or technical development to the prejudice of consumers'.

⁴ Case COMP/C-3/37.792 *Microsoft* [hereinafter: *Microsoft*].

integrated into the operating system be viewed with less suspicion? The effects of the Decision are plentiful while not all are lucid.

1.1 Purpose

The purpose of this thesis is to provide a window into the multifaceted and extensive decision in *Microsoft* in an effort to clarify the legal status of tying in EC competition law. By examining the Commission's analysis in addition to the views presented by legal scholars and practitioners, the complexity of tying as a market phenomenon is accentuated. A number of questions have formed the basis for this thesis. An initial question was which criteria that were used by the Commission to assess the tying practice in *Microsoft*, i.e. what method of assessment was employed to establish abusive tying? Did this method differ from earlier case law, and if so - how? What material facts led the Commission to conclude that Microsoft's tying arrangement constituted an abuse of Article 82 (d)? Finally, what effects does *Microsoft* have on EC competition law and what are the main objections against the Decision?

1.2 Delimitation

I have chosen to limit my thesis in several aspects in order to maintain a sharp focus on my key issue. Firstly, I have restricted my thesis to the Decision taken by the European Commission on 24 March 2004. Thus, the subsequent rulings by the Community Courts concerning Microsoft are not discussed any further nor do I examine the effectiveness of the decided remedies. Similarly, the US case concerning Microsoft⁵ is mentioned only concisely in a comparative context while other cases concerning practices on Microsoft's behalf are not awarded any further discussion. Secondly, I have chosen to examine only part of the Decision, namely the part concerning tying of products under Article 82 (d) of the EC Treaty. Hence, the issue of tying Windows Media Player with Windows is my focal point. Consequently, I do not delve further into the Microsoft's abuse of Article 82 (b). In addition, although the tying practice also infringed Article 54 of the EEA Agreement - this is not a provision that is further examined in this thesis. Thirdly, I predominantly analyse the abusive tying practice portrayed in *Microsoft* and only in brief touch upon other cases of abusive tying. Fourthly, my intention with this thesis is to clarify the legal significance of the Decision in EC competition law rather than the economic implications of the same. Naturally, to the degree that these perspectives correlate the economic aspects are discussed.

Finally, it was never my intention to provide an exhaustive picture of the complexity of EC competition law or of Article 82 at large. Instead, subparagraph (d) of Article 82 is of primary interest for this thesis. Hence,

⁵ *US v. Microsoft*, 253 F.3d 34 (D.C.Cir.2001) [hereinafter: *US v. Microsoft*].

for further reading on EC competition law and Article 82, I recommend the works of Valentine Korah,⁶ and Paul Craig and Gráinne de Búrca.⁷

1.3 Method and Material

In the process of writing this thesis, the traditional method for legal research was used. The studied sources of primary law are predominantly Article 82 of the EC Treaty in addition to complementary legislation, and tying-related case law by the Community Courts and the Commission. Naturally, the Commission's analysis in *Microsoft* is afforded much attention. However, case law on tying is scarce, and the Courts have never before decided upon a case of technical integration as was employed by Microsoft. Hence, secondary sources, such as articles and publications by various legal scholars and practitioners, have proved to be a valuable source of information.

As illustrated by the bibliography, the majority of the secondary sources are EC documents, articles and internet sources. Only two books, i.e. the works of Valentine Korah, and Paul Craig and Gráinne de Búrca, were used when writing this thesis. The reason why these books were selected is that they represented the views of well renowned legal scholars in EC competition law. The reason why only two books were used is rather simple - as the Decision was delivered as late as in 2004 - books dealing with the complex case are yet to be published. Thus, while Korah's book provide a brief summary of the Decision and its main issues, the two books were essentially used in relation to the introductory Chapter concerning tying within the meaning of Article 82 (d).

For a more fluent and comprehensible reading, I have made an effort to avoid the, at times, extremely technical language of the Decision. Still, given the nature of the tie, certain technical capabilities are decisive for the outcome of the case and deserve a more detailed discussion. Thus, to the extent technical terms are used, an explanation is provided.

1.4 Disposition

The subsequent Chapter of this thesis presents an overview of Article 82 (d) with the purpose of placing tying in its proper context and provide a general idea of the criteria discussed by the Commission in *Microsoft*. The Chapter is not intended to present a complete image of this complex provision but rather provide the reader with an abstract of the same. In order to fully grasp the Decision and its implications on EC competition law, an understanding of the underlying principles of tying is necessary. In Chapter 3, the focal point is narrowed while turning to methods of assessing tying arrangements. The Chapter presents different approaches taken by the Commission and the Community Courts in tying cases with particular emphasis on the

⁶ Valentine Korah, *An Introductory Guide to EC Competition Law and Practice*, 8th ed., Oxford, Hart, 2004 [hereinafter: *Korah*].

⁷ Paul Craig and Gráinne de Búrca, *EU Law –Text, Cases and Materials*, 3rd ed., Oxford, Oxford University Press, 2003 [hereinafter: *Craig and de Búrca*].

assessment in *Microsoft*. Hence, Chapter 3 provides the frame for the assessment of abusive tying. Yet, it is in the next Chapter that the canvas is painted by presenting the Commission's reasoning in relation to the facts and findings in *Microsoft*. The Chapter is an effort to provide an objective summary of the Commission's assessment of Microsoft's tying practice – it does not reflect my views as the author or the views of third parties. Instead, Chapter 5 will look to the effects of *Microsoft* from an EC competition law perspective and equally bring forth some of the criticism facing the Decision. Finally, my analysis in respect of tying and the *Microsoft* decision is presented along with some concluding remarks.

2 Tying within the meaning of Article 82 (d)

2.1 The Provision

Article 82 (d) of the EC Treaty:

‘Any abuse by one or more undertakings of a dominant position within the common market or in a substantial part of it shall be prohibited as incompatible with the common market insofar as it may affect trade between Member States.

Such abuse may, in particular, consist in:

[...]

(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.’

2.2 The Criteria

A principal criterion of Article 82 is that the relevant undertaking⁸ or undertakings must be in a dominant position within the common market or, in any case, within a substantial part of it, or else the prohibition on abusive conduct will not come into effect. Hence, the first part of this Section establishes the separate factors which render an undertaking dominant within the meaning of Article 82 (d). Thereafter, the criterion of abuse, i.e. tying, is considered. The Section provides an outline of tying while the more in-depth analysis of the assessment of tying is presented in Chapter 3. However, it does not suffice to establish that an undertaking is abusing its dominant position on the market by tying; this behaviour must furthermore affect trade between Member States for the prohibition in Article 82 to apply. Thus, the matter of effect on trade between Member States is discussed thereafter.

2.2.1 Dominant Position

As mentioned above, an undertaking’s *dominant position* is at the centre of Article 82. However, the provision does not give further guidance as to the definition of dominance. In the absence of clear legislation, earlier case law

⁸ The definition of an undertaking includes every entity that engages in economic activity not considering its legal status or the manner in which it is financed: Case T.128/98, *Aéroport de Paris v. Commission* [2000] ECR II-3929, para.107. In respect to Microsoft, the Commission simply concluded that the company was an undertaking within the meaning of Article 82, *Microsoft*, para.318.

is useful to assess the meaning of the phrase. In *United Brands*,⁹ the ECJ established a definition of a dominant position as ‘a position of economic strength enjoyed by an undertaking which enables it to prevent effective competition being maintained on the relevant market by giving it the power to behave to an appreciable extent independently of its competitors, customers and ultimately of consumers.’¹⁰ The ECJ has since used this definition in practically all its judgments.¹¹

Still, a definition of the relevant market is a precondition when deciding upon the issue of dominance. In *Continental Can*,¹² the ECJ urged the Commission to assess market power using a two-step procedure. First, the relevant market should be defined while specifying the reasons for its selection. Second, the relevant undertaking’s dominance therein must be appraised. In order to decide what constitutes the relevant market, three important variables are used: the product market, the geographical market and the temporal factor.¹³

2.2.1.1 Relevant Product Market

To determine and isolate the *relevant product market* is a central part of the Commission’s task when deciding upon the matter of dominance. Often, the company concerned contests the adopted definition of relevant product market by arguing that the Commission has decided upon an excessively narrow definition of the relevant product market. The underlying reason why firms oppose such a definition is that a more narrowly defined market enhances the risk of the Commission finding dominance therein.¹⁴

In 1997, the Commission published a Notice on the definition of the relevant market.¹⁵ This Notice defines the relevant product market as comprising ‘all those products and/or services which are regarded as interchangeable or substitutable by the consumer, by reason of the products’ characteristics, their prices and their intended use’.¹⁶ Hence, when defining the relevant product market, the Commission and the Community Courts generally address the issue by focusing on *interchangeability*, i.e. the degree to which the relevant good or service is inter-changeable with another product. In order to decide the extent to which the products are inter-changeable, an analysis of both demand-side and supply-side substitutability is necessary.¹⁷ A demand side analysis involves an examination of cross-elasticities of the relevant product. Cross-elasticity in a product is ascertained by studying to what extent customers will change to another

⁹ Case 27/67, *United Brands Company and United Brands Continentaal BV v. Commission* [1978] ECR 207 [hereinafter: *United Brands*].

¹⁰ *United Brands*, para. 65.

¹¹ Korah, p. 94.

¹² Case 6/72 *Europemballage Corporation & Continental Can Co. Inc. v. Commission* [1973] ECR 215, paras 32 and 37.

¹³ Craig and de Búrca, p.994.

¹⁴ Craig and de Búrca, p.994.

¹⁵ Commission Notice on the Definition of the Relevant Market for the Purposes of Community Competition Law (OJ C 372, 9.12.1997, p.5), [hereinafter: *Notice on the definition on the relevant market*].

¹⁶ Notice on the definition on the relevant market, para.7.

¹⁷ *Microsoft*, para.321-322.

product if faced with a price increase. High cross-elasticity, i.e. when a large number of customers will switch product in case of a price increase, indicates that the different products are in fact part of the same product market. However, it may prove difficult to find reliable data on cross-elasticity in products.¹⁸ In such circumstances, the Commission and the Courts consider other factors such as price and physical characteristics of the products to determine whether they are in fact inter-changeable.¹⁹

In addition, factors on the supply side of the market may also affect the level of interchangeability. For example, in certain cases it can be rather easy for suppliers to switch production from one product to another without incurring considerable additional costs or risks.²⁰ In such a case, the two original products may be seen as part of the same market.²¹

One important novelty in the Notice on the definition of the relevant market was the introduction of the ‘hypothetical monopolist test’.²² In accordance with this test, the relevant market can be determined by envisaging the customers’ reaction to a small (5-10 %), permanent relative price increase in the products and areas under consideration. If the original price rise would prove unprofitable because customers would change to alternative products, those substitutes should be included in the relevant product market seeing as they restrain the monopolist’s power over price. This test is applicable with regard to the relevant product market as well as the relevant geographic market. However, the Notice is not binding upon the courts and the Commission itself has continued to use the pre-existing test.²³

2.2.1.2 Relevant Geographic Market and the Temporal Factor

When defining the relevant market yet another factor is decisive - the *relevant geographic market*. The Notice on the definition of the relevant market defines the relevant geographic market as ‘the area in which the undertakings concerned are involved in the supply and demand of products or services, in which the conditions of competition are sufficiently homogeneous and which can be distinguished from neighbouring areas because the conditions of competition are appreciably different in those areas’.²⁴ Certain products are supplied all over the globe whereas the distribution of other products is limited in geographical range due to technical or practical difficulties, such as transport costs.²⁵ If no limitations are at hand, the relevant geographic market has been decided to encompass the entire European Community.²⁶ In accordance with the phrasing of

¹⁸ Craig and de Búrca, p.994.

¹⁹ The *United Brands* case is an example of when the Court weighed in the physical characteristics of the product, in that case the taste, seedlessness and softness of bananas, to establish if bananas constituted a separate market from other fruits.

²⁰ *Microsoft*, para.322.

²¹ Craig and de Búrca, p.994.

²² In the US, the test is referred to as the SSNIP test (Small but Significant and Non-transitory Increase in Prices).

²³ Korah, p.98f.

²⁴ Notice on the definition of the relevant market, para.8.

²⁵ Craig and de Búrca, p.998f.

²⁶ Case: C-53/92P, *Hilti AG v. Commission* [1994] ECR I-667 [Hereinafter: *Hilti*].

Article 82, the relevant geographic market must include ‘a substantial part of the common market’ for the provision to come into effect. Moreover, only abuse within the common market is prohibited by the provision.

Finally, the determination of the relevant market may also be affected by a temporal factor. A company may thus enjoy market power during a certain time of the year. Equally, the definition of the relevant product market in itself has a temporal element since technological evolution and consumer habits affect the market boundaries.²⁷

2.2.1.3 Market Power

Finally, after having defined the relevant market, an assessment of the firm’s market power therein must be made in order to determine whether it enjoys a dominant position. Several factors are taken into consideration in the assessment of market power, the primary indicator being the market share of the relevant firm. It is, however, difficult to identify an exact percentage of market shares that will bring the undertaking within the scope of Article 82.²⁸ Case law suggests that market shares above 40% are an indication of dominance,²⁹ whereas market shares above 50% are considered evidence of dominance unless exceptional circumstances are present.³⁰ In cases where the market share of the undertaking concerned has been in the range of 70-80%, it provided a presumption of dominance.³¹ If no actual competitors are left on the relevant market, the dominant undertaking is considered to have a market position approaching that of a monopolist.³² Such a position has been referred to as *super-dominant*.³³ Alternatively, as it was phrased in *Microsoft*, where the company’s market share was over 90%, an *overwhelmingly dominant position*.³⁴

Other relevant factors when assessing market power are barriers to entry, the competitors’ market shares, technological lead and the absence of potential competition.³⁵ Economies of scale have also been considered a factor.³⁶

2.2.2 Abusive Tying

2.2.2.1 General Principles on Abuse

As mentioned in the introduction, the purpose of Article 82 is not to prohibit market power *per se* but to control it by not tolerating abuse by a dominant

²⁷ Craig and de Búrca, p.1000.

²⁸ Craig and de Búrca, p.1002.

²⁹ *United Brands*.

³⁰ Case C-62/86, *Akzo Chemie BV v. Commission* [1991] ECR I-3359, paras 59-61.

³¹ *Hilti*, para. 89.

³² Case 85/76, *Hoffman-La Roche and Co. AG v. Commission* [1979] ECR 461 [hereinafter: *Hoffman-La Roche*], paras. 38-39. Case T-228/97 *Irish Sugar plc v. Commission* [1999] ECR II-2969, paras.186 and 233.

³³ The term super-dominant was referred to in the UK decision *Napp Pharmaceutical Holdings Limited Subsidiaries v. Director General of Fair Trading*, 15 January 2002.

³⁴ *Microsoft*, para.435.

³⁵ *Hoffman-La Roche*, para. 48

³⁶ *United Brands*.

undertaking.³⁷ Still, while dominance in itself is not prohibited, a firm in a dominant position ‘has a special responsibility not to allow its conduct to impair undistorted competition on the common market.’³⁸ Thus, a dominant firm may be prohibited to act in a certain manner even though the act in itself is not abusive and would be acceptable if carried out by a non-dominant firm.³⁹

The concept of *abuse* has been defined by the Court of Justice as ‘an objective concept relating to the behaviour of an undertaking in a dominant position which is such as to influence the structure of a market where, as a result of the very presence of the undertaking in question, the degree of competition is weakened and which, through recourse to methods different from those which condition normal competition in products or services on the basis of the transactions of commercial operators, has the effect of hindering the maintenance of the degree of competition still existing in the market or the growth of that competition.’⁴⁰ A dominant undertaking may protect its own interests when challenged by competitors but an effort to strengthen its dominant position is considered an abuse.⁴¹ In addition, a firm in a *super-dominant* position may have even greater responsibility towards its competitors and different considerations may apply.⁴² This is relevant information when considering the Commission’s reasoning in *Microsoft*.

Moreover, as established in *Tetra Pak II*, Article 82 is applicable in a situation where a dominant undertaking abuses its position to create adverse effects on a market in which the undertaking is not dominant but which is linked to the dominant market.⁴³ This is relevant in respect to the *Microsoft* case since it is the company’s dominant position in the client PC operating system market which created the anticompetitive effects on the tied market for streaming media players.

It is also important to consider *who* Article 82 is meant to protect. Is the provision in place to protect consumers, competitors or both? The answer to this vexed question differs. If the aim is to protect both groups, inevitably there will be moments when the interests of these two groups collide. Measures that are beneficial for consumers may at the same time be harmful for competitors.⁴⁴ This is also an issue that raised much debate in connection to the Decision in *Microsoft*. Some argue that the Commission’s reasoning protected Microsoft’s competitors rather than its consumers. Further discussion in relation to this topic is provided in Chapter 5.

³⁷ Craig and de Búrca, p.992.

³⁸ Case 322/81, *Nederlandsche Banden-Industrie Michelin NV v. Commission* [1983] ECR 3461, [hereinafter: *Michelin*], para. 57.

³⁹ *Michelin*, para. 57.

⁴⁰ *Hoffman-La Roche*, para. 91

⁴¹ *United Brands*, para.189.

⁴² Case 395/96P, *Compagnie Maritime Belge Transports SA v. Commission* [2000] ECR I-1365, paras 132 and 137.

⁴³ Case C-333/94P, *Tetra Pak International SA v. EC Commission* [1996] ECR I-5951 [hereinafter *Tetra Pak II*], para.25.

⁴⁴ Craig and de Búrca, p.1006.

2.2.2.2 Definition of Tying

Article 82 (d) defines *tying* as 'making the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their very nature or according to commercial usage, have no connection with the subject of such contracts.' A similar definition can be found in the Commission's Guidelines on Vertical Restraints which states that 'tying exists when the supplier makes the sale of one product conditional upon the purchase of another distinct product from the supplier or someone designated by the latter.'⁴⁵

In brief, an undertaking may very well provide additional products to the buyer as long as the buyer so wishes. The prohibition comes into play where the supplier refuses to supply the first product, over which he has market dominance, unless the buyer also acquires an additional product. Such behaviour risks foreclosing competition in the market for the supply of the second product.⁴⁶ The initial product in this context is referred to as the *tying product* and the supplementary product is the *tied product*.⁴⁷

As illustrated by the discussion in the following Chapters and portrayed by the decision in *Microsoft*, the EC Commission has adopted a disapproving position towards tying. The EC Commission is alarmed by dominant undertakings extending their market power from one market into another and fears that this may eliminate suppliers in the second market and thus weaken effective competition therein.⁴⁸

Further analysis on the assessment of tying is presented in Chapter 3.

2.2.2.3 Distinction between Bundling and Tying

Bundling occurs when the supplier offers a package consisting of two or more products. *Pure bundling* is when the bundle is the sole offer and the separate components cannot be purchased individually. Another distinguishing feature of a pure bundle is that the products are offered only in a fixed quantity.⁴⁹ The situation where the components can be purchased separately from the bundle is referred to as *mixed bundling* if the bundle is sold at a discount to the individual components.⁵⁰

As mentioned previously, *tying* within the meaning of Article 82 (d) is characterized by the supplier making the sale of one product conditional upon the acquisition of another distinct product. However, there are two separate definitions of tying; the first portrays it as a special case of mixed bundling (static tie) whereas the second describes it as a dynamic form of a pure bundle (dynamic tie). In the *static tie*, only the additional product, i.e.

⁴⁵ Commission Notice: Guidelines on Vertical Restraints, OJ C291, 13.10.2000 [hereinafter: *Guidelines on Vertical Restraints*], para. 215. The Guidelines essentially deal with vertical restraints falling under Article 81 but may be helpful in assessing the Commission's view on abusive tying of products.

⁴⁶ Korah, p.140.

⁴⁷ Guidelines on Vertical Restraints, para. 215.

⁴⁸ Korah, p.140.

⁴⁹ Barry Nalebuff, *Bundling, Tying, and Portfolio Effects*, DTI Economics Paper No. 1, Part 1 Conceptual Issues, February 2003 [hereinafter: *Nalebuff*], p.13, <http://www.dti.gov.uk/files/file14775.pdf> last visited 4 January 2007.

⁵⁰ Nalebuff, p.14.

the tied product, can be purchased separately. Hence, the customers do not have the opportunity to buy the tying product individually because the dominant firm refuses to sell it without the tied product.⁵¹ A *dynamic tie* is similarly characterized by the customer being forced to purchase the tied product along with the tying product. However, in this case, the tied product is not available for individual purchase. Moreover, the tied product is necessary for the usage of the tying product. The dynamic tie is similar to a pure bundle except that the quantity of the tied product varies.⁵² Tying can also be divided into categories of contractual versus technical tying. *Contractual tying* is when a firm in dominant position deprives its customers of the option to buy the tying product without the tied product through a contractual obligation. *Technical tying* is when the tying product physically integrates the tied product.⁵³

Both tying and bundling may infringe Article 82 (d). However, my focus is on tying since this was the relevant abuse found in *Microsoft*. The tying practice engaged by Microsoft was a static technical tie since Windows Media Player was physically integrated in Windows and the operating system could not be purchased without the WMP whereas the tied product was available for individual purchase.

2.2.3 Effect on Trade between Member States

Finally, as a last compulsory element of the prohibition contained in Article 82, is the effect on trade criterion. The wording ‘may affect trade between Member States’ is an effort to define the boundaries between Community law and national law. The concept, which is present in both Article 81 and Article 82 EC, has been analysed by the Commission in its 2004 Notice.⁵⁴ It has been concluded that the effect on trade criterion is satisfied when a dominant undertaking is capable of influencing, directly or indirectly, actually or potentially, the trade between Member States.⁵⁵ Hence, the condition is quite easily fulfilled. Still, it is necessary to establish a minimum level of cross-border effects which is emphasized by the Commission’s Notice stating that the effect must be *appreciable*.⁵⁶ However, Article 82 does not require that the abusive conduct actually has affected trade to an appreciable extent but it must be capable of producing such an effect. Even an agreement which relates to activities within a single Member State may infringe Article 82.⁵⁷

⁵¹ Nalebuff, p.15.

⁵² Nalebuff, p.16.

⁵³ DG Competition discussion paper on the application of Article 82 of the Treaty to exclusionary abuses, Brussels, December 2005 [hereinafter: *DG Competition*], paras 177 and 182. <http://ec.europa.eu/comm/competition/antitrust/others/discpaper2005.pdf> last visited 4 January 2007

⁵⁴ Commission Notice: Guidelines on the effect on trade concept contained in Articles 81 and 82 of the Treaty, OJ 2004, C101/81 [hereinafter: *Notice on trade concept*]

⁵⁵ Joined cases C-215/96 and C.216/96 *Bagnasco v. BNP and others*, [1999] ECR, I-135, para. 47.

⁵⁶ Notice on trade concept, para. 13.

⁵⁷ Korah, p.62.

In *Microsoft*, the Commission held that the tying practice employed by Microsoft to an appreciable extent weakened effective competition in the world-wide market for media players. Hence, Microsoft's conduct had an appreciable effect upon trade between Member States.⁵⁸

2.3 Rationale behind the Paragraph

2.3.1 Incentives to Tie

Integrating two products can lead to substantial savings in costs relating to production, distribution and transaction while at the same time, quality of the product may be improved. Other reasons for tying are related to the reputation of the firm and good usage of machinery.⁵⁹ Tying can thus produce a positive effect on both consumer welfare and the economic situation of the relevant undertaking. As described below, efficiencies may constitute a possible defence for tying (3.2.3.2).

However, the practice may also be employed for less commendable reasons, such as price discrimination or leveraging market power.

2.3.2 Motives for its Prohibition

In general, the dynamic tie is economically motivated by price discrimination, i.e. charging different customers different prices based on how they value the product.⁶⁰ In a situation where the customers' valuation of the product is linked to the proportion of usage, a two-part pricing scheme will generally prove most profitable for the company. The initial price of the product is reduced and a per-use fee is added. This solution will result in the high-value customers paying a higher total price whereas the company is still profiting from the initial sale to low-value customers.⁶¹ Many economists argue that price discrimination in fact add to consumer welfare but according to Nalebuff price discrimination will not lead to efficiencies mainly because there is no such thing as perfect price discrimination.⁶²

In respect to *Microsoft* another motive for tying is more relevant. Both the dynamic tie and the static tie may be employed for strategic reasons in an effort to leverage market power. This has raised much concern since it can produce highly anticompetitive effects on the market. The Community Courts have focused primarily on situations where a dominant firm in the tying market uses its market power to generate a second monopoly position in the tied market.⁶³ This is also a concern for the Commission in *Microsoft*. However, Nalebuff further accentuates the anticompetitive effect tying may have on the tying market. If tying brings

⁵⁸ *Microsoft*, paras 992 and 993.

⁵⁹ DG Competition, para. 178.

⁶⁰ Nalebuff, p.16.

⁶¹ Nalebuff, p.70f.

⁶² Nalebuff, p.77.

⁶³ Nalebuff, p.71.

about exit in the tied market, the result may be a reinforced position of the dominant undertaking in the tying market due to entry deterrence. Reduced possibility to enter is likely because (i) the potential entrants would probably have come from the tied market or (ii) the reduced competition in the tied market is used to raise competitors' costs in the tying market as the tied product is a necessary complement.⁶⁴ These concerns are also taken into consideration in view of Microsoft's justifications (see Section 4.5).

There is much to say about the economic theories surrounding tying. However, since the spectrum of this thesis is limited to address the legal aspect of *Microsoft*, these theories are deliberately left without further discussion.⁶⁵

⁶⁴ Nalebuff, p.71.

⁶⁵ For an introduction to the economic theories with respect to tying I recommend GCLC Research Papers on Article 82 EC, July 2005 [hereinafter: *GCLC Research Papers*] <http://www.coleurop.be/content/gclc/documents/GCLC%20Research%20Papers%20on%20Article%2082%20EC.pdf> last visited 4 January 2007.

3 Methods of Assessing Tying

3.1 Assessment prior to *Microsoft*

In Europe, the case law concerning the assessment of tying is underdeveloped. In only two cases has the ECJ examined the conditions of abusive tying: *Hilti* in 1994 and *Tetra Pak II* in 1996. Both of these cases concerned contractual tying and thus involved products that were physically distinct. These cases stand in contrast to *Microsoft* in which a technical tie was involved.⁶⁶

Prior to the decision in *Microsoft*, tying was considered *per se* prohibited under Community law. *Per se* rules represent virtually absolute prohibitions subject only to a restricted number of defences and are generally only applied in connection with manifestly anticompetitive conducts. Hence, tying as such was prohibited and there was no need for case-by case evaluations.⁶⁷ Tying arrangements were assessed by reference to their form rather than their effects. The Commission and the Community Courts did not consider whether the relevant conduct was harmful or possibly beneficial to consumers.⁶⁸ The employed methodology to expose abusive tying under the *per se* prohibition approach was to establish (i) market power, (ii) separate products and (iii) coercion. In theory, there was the possibility of objectively justifying tying but this exception had little relevance in practice.⁶⁹

What differentiated this methodology to that subsequently used in *Microsoft* was essentially that the risk of anti-competitive effects in the tied market was not a prerequisite. Hence, the element of foreclosure effect as described below (Section 3.2.2.4) was not present.⁷⁰ This previous approach was reflected in *Hilti*, where the Commission declared that depriving consumers of choice by tying products together in itself constituted abusive exploitation.⁷¹ The *per se* prohibition approach is consistent with the view presented in the Commission's Guidelines on Vertical Restraints.⁷²

3.2 Assessment in *Microsoft*

The purpose of this Section is to illustrate the structure of analysis employed by the Commission in *Microsoft*. Following a brief background of the case,

⁶⁶ David S. Evans and A. Jorge Padilla, Tying Under Article 82 EC and the Microsoft Decision: *A Comment on Dolmans and Graf*, 27 August 2004, World Competition: Law and Economics Review 2005, [hereinafter: *Evans and Padilla*], p. 6 and 9. http://papers.ssrn.com/sol3/papers.cfm?abstract_id=596663#PaperDownload last visited 4 January 2007

⁶⁷ GCLC Research Papers, p.177 and 185.

⁶⁸ GCLC Research Papers, p.185f.

⁶⁹ GCLC Research Papers, p.192.

⁷⁰ GCLC Research Papers, p.192 and 194.

⁷¹ *Hilti*.

⁷² Guidelines on Vertical Restraints, paras 141 and 215.

the four elements which guided the Commission's assessment of tying are presented. In the DG Competition discussion paper, three of them were further examined.

3.2.1 Background

In May 1999, Microsoft released Windows 98 Second Edition which included a streaming media player with playback capabilities (WMP). According to the Commission, this was the beginning of Microsoft's abusive tying practice. Before the release of WMP with Windows, Microsoft had been unable to compete in the market for streaming media players due to unsatisfactory technological capacities.⁷³

All subsequent versions of Windows came to include a pre-installed version of WMP as a non-removable component of the operating system.⁷⁴ Hence, Microsoft did not distribute any edition of Windows without the WMP integrated. By tying WMP with Windows, Microsoft ensured a significant competitive advantage in the tied market. In view of the fact, that Microsoft's market share in the client PC operating system market was over 90%, tying presented an extremely effective method of distributing WMP. In addition, it was a distribution channel only accessible to Microsoft as the overwhelmingly dominant player in the tying market. In 2002, 114 million out of a total of 121 million client PC operating systems distributed worldwide had Windows pre-installed. The Commission examined the different distribution channels in the media player market and concluded that there was no other distribution mechanism as effective as the one controlled by Microsoft.⁷⁵

Furthermore, due to indirect network effects resulting from Microsoft's conduct, high barriers to entry was produced. Most content providers, developers and end-users began to rely on WMP format as Microsoft's tying of WMP guaranteed that the media player was as ubiquitous on the market as Windows.⁷⁶ In addition, the WMP no longer natively supported competitors' formats.⁷⁷

In light of the above mentioned facts, the Commission argued that Microsoft had infringed Article 82 (d) of the EC Treaty by illegally tying Windows Media Player with Windows PC operating system.⁷⁸

3.2.2 The Four Elements

3.2.2.1 Dominant Position in the Tying Market

In *Microsoft*, the Commission presented *dominance* in the tying market as one of the four elements of tying.⁷⁹ Thus, in the absence of a dominant position in the tying market the practice is not abusive under Article 82 (d).

⁷³ *Microsoft*, paras 302-310.

⁷⁴ *Microsoft*, para. 310.

⁷⁵ *Microsoft*, para. 843.

⁷⁶ *Microsoft*, para. 844.

⁷⁷ *Microsoft*, para. 311.

⁷⁸ *Microsoft*, para. 984.

⁷⁹ *Microsoft*, para. 799, referring to Section 5.2.1 of the Decision.

Dominance in the tied product market, however, is not a prerequisite. Still, if the company holds a dominant position in both markets it enhances the odds of finding abusive tying. To determine if the undertaking concerned is dominant, the relevant markets for the tying product as well as the tied product must be defined.⁸⁰ The assessment of dominance and definition of markets is conducted in the manner described above (Section 2.2.1).

3.2.2.2 Separate Products

The second precondition for tying established by the Commission in *Microsoft* was the existence of *separate products*. Tying cannot be contrary to Article 82 if the products are not distinct, i.e. there exists distinct markets for the different products. Hence, in an effort to fall outside the scope of Article 82, many companies try to argue that the products are indistinct. Especially if the products are used in conjunction with each other or are technically integrated which was the case in *Microsoft*.⁸¹ The same line of reasoning was presented in *Tetra Pak II* and *Hilti*. In both cases, however, the argument was rejected after the Court had established the existence of independent manufacturers who specialised in the manufacture of the tied product.⁸² This displayed separate consumer demand for the tied product which is the determining factor when deciding upon the issue of separate products. If, in the absence of tying, the products would be bought separately they should be viewed as separate products.⁸³

Support of the finding of separate products can either consist in direct or indirect evidence. An example of direct evidence is the fact that customers buy the products separately when given the choice. Examples of indirect evidence are the presence of smaller undertakings that are not tying the two products together or firms that have specialized in the manufacture and sale of the tied product without the tying product. It is not necessary that this evidence derives from the relevant geographic market.⁸⁴ Alternatively, commercial usage may support that the products are *not* separate products and that the purpose for tying is not to exclude other competitors. Instead, the character of the products makes it technically difficult to supply one without the other why integration of the products has become accepted practice. Cases of integration for technical purposes stand a better chance of being considered not to be tying than cases of contractual tying.⁸⁵ Another complex issue presents itself when two products, previously regarded as separate, become integrated due to new product developments. Are the products to continue to be viewed as separate or not? The decisive factor in this respect is whether or not consumer demand has changed to the degree where independent demand for the tied product no longer exists.⁸⁶

⁸⁰ DG Competition, para. 184.

⁸¹ *Microsoft*, paras 800-801.

⁸² *Tetra Pak II*, para. 36, *Hilti*, paras 66-67.

⁸³ DG Competition, para. 185.

⁸⁴ DG Competition, para. 186.

⁸⁵ DG Competition, para. 186.

⁸⁶ DG Competition, para. 187.

3.2.2.3 Unavailability of Untied Supply

In *Microsoft* the Commission presented *unavailability of untied supply* as the third element of abusive tying. Microsoft did not provide the customers with the choice of acquiring Windows without WMP since there was no version of Windows available on the market that did not include the media player.⁸⁷

This third element of tying is not discussed in the DG discussion paper as a separate criterion but rather as an integrated part of the concept of tying. The two separate definitions of tying described above (section 2.2.2.3), i.e. static and dynamic tie, both encompass the common feature of the customers not having the opportunity to buy the tying product individually because the dominant undertaking refuses to sell it without the tied product.⁸⁸

3.2.2.4 Foreclosure Effect

The fourth, and last, element of tying as illustrated in *Microsoft* is that the tie produces a *harmful effect on competition*.⁸⁹ It is this criterion that separates the Commission's analysis from previous tying cases. In many situations tying does not have a negative impact on competition whereas in other cases, tying will result in significant anticompetitive effects such as price discrimination, higher prices or foreclosure on the tied market.⁹⁰ The foreclosure effect is regarded as a particularly negative aspect of tying and this is also what alarmed the Commission in *Microsoft*.

The case illustrates a more effects-based analysis of tying than previously employed. The Commission acknowledged that there were circumstances in the case which called for further examination before concluding what effects the tying arrangement had on the competitive climate on the market. The Commission separated *Microsoft* from classical tying cases where the foreclosure effect is demonstrated by the mere existence of tying of separate products by a dominant undertaking. In *Microsoft*, the consumers could and did obtain third party media players through the internet for free. The Commission thus expressed that 'there are therefore good reasons *not* to assume without further analysis that tying WMP constitutes conduct which by its very nature is liable to foreclose competition'.⁹¹

It is this new approach which has stirred a lively discussion among legal scholars concerning the status of tying in EC competition law. Some, including the Commission,⁹² argue that tying is no longer prohibited *per se* but that a rule comparable to the US *rule of reason* has developed. This approach includes a case-by-case evaluation of tying practices in an effort to establish whether the pro-competitive benefits of the tie outweigh the likely anti-competitive effects.⁹³ However, others perceive the Decision as a

⁸⁷ *Microsoft*, para.826.

⁸⁸ Nalebuff, p.15-16.

⁸⁹ *Microsoft*, para.835.

⁹⁰ DG Competition, para. 178.

⁹¹ *Microsoft*, para.841.

⁹² Commission Press Release of 24 March 2004, MEMO/04/70.

⁹³ GCLC Research Papers, p.177.

development of a *modified per se prohibition* rule in relation to the assessment of tying under Article 82 (d). Such an approach uses criteria as proxies for competitive harm and involves some assessment of market conditions.⁹⁴ Still, others would prefer to see a continued prohibition of tying *per se*. This ongoing discussion is presented in more detail in Chapter 5.

The DG Competition discussion paper suggests a two-step analysis to assess the market effect of foreclosure. The first step is to establish which customers that are tied to the dominant firm in a way that forecloses competition from other competitors. The second step is to determine if these customers result in a large enough part of the relevant market being tied. Decisive factors in this respect are the tied percentage of total sales on the market of the tied product, the general power of the dominant firm on the tying and the tied markets as well as the identity of the customers that are tied.⁹⁵ Other factors include the existence of economies of scale, learning curve, network effects or entry barriers in the tied market which may all add to the foreclosure effect.⁹⁶ In addition, effective counter-strategies of rivals and customers may influence the foreclosure by limiting its negative effect on the market.⁹⁷

Still, after having followed this two-step procedure, a general appraisal of the possible foreclosure effects by analyzing the practice, its employment on the relevant market and the degree of dominance of the undertaking is necessary.⁹⁸

3.2.3 Possible Defences

Article 82 has no equivalent to the exemptions provided in Article 81 (3) of the EC Treaty. When drafted, the abuse of monopoly power was considered unjustifiable and hence no exceptions to this behaviour were acceptable.⁹⁹ However, the courts have gradually changed their position from total condemnation to a more flexible approach and as a result concepts of *objective justification* and *efficiencies* have developed in case law.¹⁰⁰ Hence, the prohibitions of Article 82 can be set aside in cases where the undertaking concerned presents an objective justification for its exclusionary conduct or demonstrates how efficiencies will outweigh the anticompetitive effects.¹⁰¹ It is on the dominant undertaking invoking the defence to prove the objective justification or efficiency.¹⁰²

⁹⁴ GCLC Research Papers, p.177.

⁹⁵ DG Competition, para. 196.

⁹⁶ DG Competition, para. 199.

⁹⁷ DG Competition, paras 202 and 203.

⁹⁸ DG Competition, para. 188.

⁹⁹ Craig and de Búrca, p.1030.

¹⁰⁰ See, e.g., *United Brands* and *Hilti*.

¹⁰¹ E.g. *United Brands*, paras 182-184, and *Tetra Pak II*, paras 115, 136 and 207.

¹⁰² Council Regulation (EC) 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty, OJ L 1, 04.01.2003, recital 5 and Article 2. See also Case T-203/01 *Manufacture française de pneumatiques Michelin v. Commission* [2003] ECR II-4071, paras 107-109.

3.2.3.1 Objective Justifications

The phrasing of Article 82 (d) as well as the Guidelines on Vertical Restraints clarify that tying may only constitute an abuse if it is not objectively justified by commercial usage or the nature of the products.¹⁰³ However, in *Tetra Pak II*, the notion of commercial usage was examined as a possible justification for tying rather than as an element of the definition of abuse. As a consequence, the burden of proof shifted from the ECJ to Tetra Pak.¹⁰⁴

A possible objective justification for otherwise abusive tying is the *objective necessity defence*. This is the case when the dominant undertaking argues that its conduct is necessary based on objective factors external to the undertakings involved, i.e. factors that are relevant to all undertakings in the market. The underlying reasons for its actions may be to maintain good usage or quality of the products in an effort to protect the health or safety of customers. The main issue for the dominant undertaking is to demonstrate that without the actions taken the production and distribution of the relevant product could not have happened - the condition of indispensability is applied strictly by the Community Courts in these cases.¹⁰⁵ The dominant undertaking may not on its own authority take action to eliminate products it considers inferior or unsafe in comparison to its own products.¹⁰⁶

3.2.3.2 Efficiencies

Efficiencies can also serve as a possible defence for what would otherwise be regarded as abusive tying by a dominant undertaking. The company concerned may argue that integrating products results in lower costs in production, distribution or transaction.

For the Community Courts to accept an efficiency defence, four conditions must be fulfilled. First, the dominant undertaking must show that the adopted behaviour, in our case tying, have resulted or is likely to result in the claimed efficiencies. Second, the company must demonstrate that the tying practice was indispensable in order to achieve the efficiencies. Hence, while considering the relevant market conditions and business realities, the dominant undertaking must show that there was no alternative economically practical and less anticompetitive course of action.¹⁰⁷ Third, the efficiencies generated by the tying practice must benefit the consumers. Hence, the company must demonstrate that the efficiencies outweigh the potential anticompetitive effects connected with tying.¹⁰⁸ Fourth, and last, the dominant undertaking must show that competition is not and will not be eliminated with reference to a substantial part of the products concerned. If competition is eliminated, the immediate efficiency gains are outweighed by the long-term negative effects on competition such as reduced innovation,

¹⁰³ Guidelines on Vertical Restraints, para. 215.

¹⁰⁴ In accordance with Article 2 of Regulation 1/2003, the burden to establish an infringement of Article 82 rests with the Court after which the onus of justifying an abuse rests with the dominant firm.

¹⁰⁵ DG Competition, paras 78, 80 and 204.

¹⁰⁶ *Hilti*, para. 118; *Tetra Pak II*, paras. 83-84 and 138.

¹⁰⁷ DG Competition, paras 84-86.

¹⁰⁸ DG Competition, para. 87.

higher prices and misallocation of resources. Hence, the emphasis of this fourth condition is the significance of rivalry between undertakings in creating economic efficiency. Since protecting competition is prioritized over potential efficiency gains, it is not very likely that an undertaking in a dominant position approaching that of a monopolist can justify abusive conduct claiming efficiencies.¹⁰⁹

¹⁰⁹ DG Competition, para. 91.

4 Why Tying WMP with Windows was found Abusive

In this Chapter, the four elements of tying illustrated in *Microsoft* are examined in relation to the facts and findings of the Decision. Thereafter, the justifications put forth by Microsoft are presented.

4.1 Microsoft's Dominant Position in the Client PC Operating System Market

The first precondition for tying recognised by the Commission in *Microsoft* was dominance in the tying market. Hence, Microsoft's dominant position in the market for client PC operating systems was a necessary ingredient in what, according to the Commission, constituted tying within the meaning of Article 82 EC. This Section provides a review on the Commission's reasoning in this part.

4.1.1 The Relevant Product Market

As a first step in its economic and legal assessment, the Commission outlined the relevant markets in order to determine whether Microsoft held a dominant position therein. With regard to the issue of tying, the relevant product markets defined by the Commission were the market for client PC operating systems and the market for streaming media players.¹¹⁰ It was Microsoft's dominance in the market of the tying product, Windows, that rendered the technical integration of the tied product, WMP, abusive.¹¹¹ The market for streaming media players was examined as a reference market depicting the products and vendors that were foreclosed by the tying practice applied by Microsoft. The market was not studied to conclude whether Microsoft held a dominant position therein.¹¹²

4.1.1.1 Client PC Operating Systems

Before reaching to the conclusion that the relevant product market with respect to Windows was the client PC operating system market, the Commission considered both demand-side and supply-side substitution.

The Commission started by looking at interchangeability on the demand-side, i.e. potential substitute products from the viewpoint of a client PC user. It established that the special features of client PC operating systems were to administer the PC hardware and provide an interface to interact with the PC in addition to run applications.¹¹³ As a consequence, operating systems for computers other than PCs were not substitutes for

¹¹⁰ *Microsoft*, para. 323.

¹¹¹ *Microsoft*, para. 799.

¹¹² *Microsoft*, para. 403.

¹¹³ *Microsoft*, para. 324.

client PC operation systems since they were generally not used on client PC hardware. Similarly, other software products were not substitutes because they lack the capacity to take full advantage of the hardware capabilities of the PC. The Commission thus concluded that from the client PC users' point of view the client PC operating systems constitute a specific demand based on characteristics and intended use.¹¹⁴ Operating systems for other client appliances and server operating systems were also ruled out as substitutes due to concrete differences in functionalities and price compared to client PC operating systems.¹¹⁵ The Commission therefore found that there was no realistic demand-side substitutability.¹¹⁶

Next, the Commission considered possible supply-side substitutability but came to the conclusion that suppliers would not be able to alter their production to client PC operating systems without sustaining significant additional costs and risks. Moreover, the time it would take to switch production excluded it from the scope of consideration in terms of supply-side substitutability.¹¹⁷

Hence, the Commission concluded that the relevant product market in this aspect of the case was the market for client PC operating systems on account of the specific characteristics and the non-existence of realistic substitutes.¹¹⁸

4.1.1.2 Streaming Media Players

As mentioned previously, the market for streaming media players was examined solely as a reference market and not in an effort to assess dominance therein.

The Commission commenced its analysis by determining if a media player and an operating system were *separate products* before discussing potential supply-side and demand-side substitution. Media players are software applications on the client-side with the distinct functionalities to decode, decompress and play digital audio and video files which can be streamed or downloaded over the internet. Media players can furthermore play back files stored on for example CDs.¹¹⁹ However, in Microsoft's view it was 'inappropriate to consider multimedia playback functionality to be a product separate from an operating system'.¹²⁰ The reasoning behind Microsoft's argument was that no client PC would be distributed without considerable multimedia functionality, including media player capabilities.¹²¹ However, the Commission disagreed and concluded that media players and operating systems were indeed separate products. The existence of software vendors specializing in media players in addition to stand-alone media player software ready to be installed in PCs were evidence to support this standpoint. In response to Microsoft's argument, the Commission stated that simply because the customers expect the

¹¹⁴ *Microsoft*, para. 325.

¹¹⁵ *Microsoft*, paras 327-332.

¹¹⁶ *Microsoft*, para. 333.

¹¹⁷ *Microsoft*, para. 341.

¹¹⁸ *Microsoft*, para. 342.

¹¹⁹ *Microsoft*, para. 402.

¹²⁰ Microsoft's submission of 1 December 2003, on page 24.

¹²¹ *Microsoft*, para. 404.

capability of playing media files on their PC it does not mean that media player is included in the operating system.¹²² The issue of separate products received a more in-depth analysis in the section of the Decision considering the criterion of separate products,¹²³ and will be further discussed below (Section 4.2.).

Next, the Commission reviewed the demand-side substitutability as regards streaming media players. First, the Commission ruled out classical playback devices such as CD or DVD players as substitutes since these products only possess a limited subset of the functionalities of a media player. The economics of these products also support the finding that the different devices meet different demand.¹²⁴ Thereafter, the Commission limited its comparison to media players. The Commission established that WMP was alone in providing all the functionalities technically available in a media player. Microsoft, on the other hand, presented other media players with comparable functionalities. However, with the exception of two media players¹²⁵ all of the media players that Microsoft referred to relied upon third parties' codecs and file formats. Thus, the Commission did not consider these media players to present a likely constraint to the third parties' behaviour.¹²⁶ Furthermore, not all media players provide media streaming. In agreement with Microsoft submissions,¹²⁷ the Commission established that consumers wanted to have the opportunity to both play and stream audio and video files. The software developers and content providers were likewise interested in the streaming media players since these allowed for applications such as paid online services. The Commission thus concluded that while streaming media players were actual substitutes for media players the reverse substitution did not satisfy consumer demand for streaming or video playback.¹²⁸

Regarding supply-side substitutability, the Commission noted that entry into the streaming media player market was difficult.¹²⁹ It required considerable investments in research, development and promotion to introduce a new streaming media player. Moreover, the media technologies available on the market were usually protected through IP-rights.¹³⁰ The indirect networks effects on the media software market also converted into barriers to entry for new firms.¹³¹ Consumers would not want to purchase the streaming media player unless there were matching digital files that the

¹²² *Microsoft*, para. 405.

¹²³ *Microsoft*, section 5.3.2.1.2.

¹²⁴ *Microsoft*, paras 408-410.

¹²⁵ RealOne Player and QuickTime Player.

¹²⁶ *Microsoft*, paras 411-413. See also Notice on the definition of the relevant market, paras 2 and 16.

¹²⁷ Microsoft's submission of 17 October 2003, on page 90 and Microsoft's submission of 23 October 2003, on page 14.

¹²⁸ *Microsoft*, para. 415.

¹²⁹ This conclusion was supported by the Commission's market enquiry carried out in April 2003, where 13 of the 16 companies that answered, considered it difficult to enter the market. See *Microsoft*, para. 419 and footnotes 532-535.

¹³⁰ *Microsoft*, paras 417-419.

¹³¹ Indirect network effects occur when the user-value of the streaming media player increases as the number and variety of complementary products increase.

player could play back.¹³² The Commission thus concluded that supply side substitutability could only derive from software vendors licensing the necessary media technology from already existing vendors (such as Microsoft). Hence, the new entrants would not likely constrain the competitive practices of these vendors since they would depend upon their co-operation.¹³³ With respect hereto, the Commission also highlighted that Microsoft, in the discussion of the effects of the inclusion of WMP in Windows, had expressed that ‘none of these companies appears to be in practice a true competitor of Microsoft’s media playing technologies.’¹³⁴ Still, even if a larger market for streaming media players was examined (including e.g. non-streaming media players), the Commission concluded that WMP and Windows media *usage* shares would remain at the same level and that the tie of WMP also foreclosed competition in the media player market at large since it was a full functional substitute for a non-streaming media player.¹³⁵

Thus, the Commission established that the market for streaming media players constituted the relevant product market based on its specific characteristics and the absence of realistic substitutes.¹³⁶

4.1.2 World-wide Geographic Market

The Commission established that the relevant geographic market in respect to both client PC operating systems and media players was worldwide seeing as the objective conditions for competition was equivalent. The basis for this conclusion was that PC and server manufacturers operated on a global market. Ordinarily, a single world-wide licence agreement was concluded with a software manufacturer to allow the sale of computers with the pre-installed operating system and media player. No significant limitations in import restrictions, transport costs or technical requirements were present. Hence, the Commission concluded that the relevant geographic market was global.¹³⁷

4.1.3 Microsoft’s Market Power

The Commission concluded that Microsoft was dominant in the market for client PC operating systems after having contemplated factors such as Microsoft’s extremely high market shares and the high barriers to entry. In fact, the Commission found that Microsoft’s dominant position in the market for client PC operating systems revealed extraordinary features as Microsoft controlled, and had controlled for some time, the quasi-standard of the relevant market.¹³⁸

¹³² *Microsoft*, para.420.

¹³³ Notice on the definition of the relevant market, paras 2 and 20.

¹³⁴ Microsoft’s submission of 17 April 2002, NERA, on page 7.

¹³⁵ *Microsoft*, para.424.

¹³⁶ *Microsoft*, para.425.

¹³⁷ *Microsoft*, para.427.

¹³⁸ *Microsoft*, para. 429.

4.1.3.1 Extremely High Market Shares

Based on third party estimates and evidence from investigation, the Commission concluded that Microsoft was in an extraordinary position in the market for client PC operating systems.

In 2002, Microsoft's market share in terms of new client PC operating system licences was 93.8% measured by unit shipments and 95.4% by revenues. In addition, this position was no recent development. Microsoft had enjoyed a market position that reflected stability and continuity. In 1996, Microsoft's market share was 76.4%, since 1997 over 80% and after the shift to the new millennium over 90%. With regard to installed base, Windows had increased its share from 84.6% to 92.8% in the years 2000 to 2002. The estimates further showed that Microsoft were most likely to maintain a market share above 90% in the near future.¹³⁹ Hence, there was only marginal competition facing Microsoft. As mentioned above, a market share of this magnitude placed Microsoft in a position similar to that of a monopolist. The Commission thus established that Microsoft was in an overwhelmingly dominant position in the market for client PC operating systems.¹⁴⁰

Initially, Microsoft had argued that the market shares to be taken into account were the market shares of individual versions of Windows. However, this line of reasoning was rejected by the Commission on the basis that it ignored the backward and forward dynamic links connecting different versions of Windows.¹⁴¹ Later, Microsoft acknowledged its dominant position in the supply of PC operating systems.¹⁴²

4.1.3.2 Significant Barriers to Entry

The Commission further noted the existence of significant barriers to entry in the market for client PC operating systems that supported the finding of dominance. It was considered extremely difficult, time-consuming, risky and expensive for new entrants to establish themselves on the market due to indirect network effects.¹⁴³ In essence, independent software vendors write applications to the most popular client PC operating systems and the more applications the operating systems have the more popular they become among users.¹⁴⁴ Microsoft acknowledged the presence of these indirect network effects on the market but preferred to refer to them as the 'positive feedback loop'.¹⁴⁵ To enter the client PC operating system market, the new product had either to support the already existing Windows-dependent applications or persuade software developers to develop applications to the new operating system.¹⁴⁶ The first alternative would involve reverse-engineering since the Windows-dependent applications relied on the Win32

¹³⁹ *Microsoft*, paras 431-433.

¹⁴⁰ *Microsoft*, para. 435.

¹⁴¹ *Microsoft*, para. 447.

¹⁴² Microsoft's submission of 17 October 2003, on page 1

¹⁴³ *Microsoft*, para. 453.

¹⁴⁴ *Microsoft*, para. 449.

¹⁴⁵ Direct testimony of Bill Gates, Civil Action No. 98-1233 (CKK), at para.25. See *Microsoft*, footnote 573.

¹⁴⁶ *Microsoft*, para. 453.

API and Microsoft did not disclose a specification for this. Due to extreme barriers and costs, this option was not considered commercially viable.¹⁴⁷ After highlighting the efforts by IBM to convince application developers to adopt its client PC operating system as an alternative to Windows, the second alternative was similarly dismissed as unfeasible. IBM, which had both the financial resources and technical capacity needed, went to great length in trying to convince the application developers but failed and had to cancel its client PC operating system.¹⁴⁸

The Commission concluded that the application developers had an undeniable economic incentive to write for Windows, as the potential market would be larger. Hence, the indirect network effects hindered effective competition in the relevant market and protected Microsoft's market shares.¹⁴⁹ The Commission further noted that Microsoft could behave largely independently of its competitors, its customers and ultimately of its consumers.¹⁵⁰ The emergence of rivals on the market did not affect Microsoft's financial performance as its pricing policy and business model remained successful. In relation to its direct customers, the original equipment manufacturers (OEMs), Windows had become an indispensable product. Even direct competitors to Microsoft such as IBM installed Windows on their PCs. Finally, Microsoft could act independently of its end-customers due to the high switching costs to using another client PC operating system.¹⁵¹

As a final observation, the Commission pointed out that the financial performance of Microsoft corresponded to its position in the market for client PC operating system, which was approaching that of a monopolist. The profit margin¹⁵² for its client PC operating system product was as high as 81%.¹⁵³

4.1.3.3 “New Economy” Industries

Microsoft vented the argument that the traditional analytical approach to define markets and decide upon market power was inappropriate when analysing “new economy” industries (such as IT industries). The argument was that the form of competition was different and that products, such as software and hardware, were at constant risk of being substituted by newer products. Hence, the notion of dominance was not well suited as there was no position of well-established market power in these industries.¹⁵⁴ However, the Commission did not accept this argument. Even if the dominant position was not static and the undertaking concerned might find itself in a different position in the future, it did not limit its *present* market power.¹⁵⁵ Still, the Commission acknowledged that the different characteristics in a market influence the assessment. Nevertheless, this did

¹⁴⁷ *Microsoft*, paras 454-455.

¹⁴⁸ *Microsoft*, paras 453-457.

¹⁴⁹ *Microsoft*, paras 458-459.

¹⁵⁰ *Microsoft*, para. 460.

¹⁵¹ *Microsoft*, paras 461-463.

¹⁵² Profit margins are profits as percentage of revenues.

¹⁵³ *Microsoft*, para. 464.

¹⁵⁴ *Microsoft*, paras 465-466.

¹⁵⁵ *Microsoft*, paras 468-469.

not exclude the application of antitrust analysis to “new economy” markets. The Commission furthermore rejected the notion that there were no positions of entrenched market power in these industries. Instead, it emphasised the high risk of the same due to networks effects and barriers to entry.¹⁵⁶

In conclusion, based on Microsoft’s extremely high market shares and the high barriers to entry, the Commission found that Microsoft had a dominant position within the meaning of Article 82 on the client PC operating system market.¹⁵⁷ Moreover, Microsoft had been in a dominant position in this market since at least 1996.¹⁵⁸

4.2 WMP and Windows were Separate Products

As mentioned previously, the second element of tying identified by the Commission was the existence of separate products. Hence, if the products were not distinct, the tie was not contrary to Article 82. Not surprisingly, Microsoft argued that WMP was not a separate product from Windows but instead an integral part of the same.¹⁵⁹

4.2.1 The Consumer Demand Test

The Commission addressed this issue by assessing *consumer demand* for WMP. The existence of vendors who developed and supplied media players separately was considered evidence for a separate market.¹⁶⁰ The Commission also argued that informed customers recognised the products as separate since a not insignificant number of customers preferred to attain media players independently from their operating systems.¹⁶¹ Microsoft, however, argued that few customers would choose to purchase Windows without WMP. This argument was dismissed by the Commission since Microsoft had failed to recognise the alternative media players on the market. The essential difference with an untied version of Windows would be that the media player chosen by the customer might very well be WMP but it would not automatically be the case.¹⁶²

While recognizing the risk of disregarding potential efficiency benefits from new product integration by applying a *per se* rule to the direct consumer demand test, the Commission excluded the risk in the present case since consumer demand existed several years after the start of the tying practice.¹⁶³

¹⁵⁶ *Microsoft*, para. 470.

¹⁵⁷ *Microsoft*, para. 471.

¹⁵⁸ In 1996, Microsoft’s market share was 76.4%, *Microsoft*, paras 472 and 432.

¹⁵⁹ *Microsoft*, para.800.

¹⁶⁰ *Microsoft*, paras 803-804.

¹⁶¹ *Microsoft*, para.809.

¹⁶² *Microsoft*, para.809.

¹⁶³ *Microsoft*, para.808.

4.2.2 Microsoft's Behaviour and Industry Structures

Moreover, the Commission noted that Microsoft's own behaviour pointed towards the conclusion that Windows and WMP were indeed separate products. For example, WMP was distributed separately from Windows for integration in other client PC operating systems; separate upgrades were released for the two products; promotion was specifically dedicated to WMP and different licensing agreements were used for Windows and WMP.¹⁶⁴ Other distinctive factors between the two products were the difference in price, the distinct functionalities of Windows and WMP as discussed above (sections 4.1.1.1-4.1.1.2) and the different industry structures illustrated by the existence of some competition in the media player market whereas in the market for client PC operating systems Microsoft was in a near-monopoly position.¹⁶⁵

4.2.3 Counter-arguments presented by Microsoft

One argument presented by Microsoft was that the company had bundled media playback software *before* 1999. However, the Commission did not accept that a potential preceding infringement of Article 82 could be used as a defence and thus exculpate Microsoft's conduct. The existence of prior tying was legally immaterial and did not preclude the Commission from pursuing a present infringement. The reason why Microsoft's tying before 1999 had not been questioned was that up until then its conduct had been counterbalanced by media player vendors supplying products that Microsoft was unable to supply. It was not until 1999 when the company tied a streaming media player with Windows that it entered the relevant product market, i.e. the market for media players with both playback and streaming capabilities.¹⁶⁶

Microsoft furthermore argued that it was normal *commercial practice* to bundle a streaming media player with the operating system. By illustrating how other software vendors integrated media players in their client PC operating systems the company wanted to demonstrate the absence of separate products. The Commission rejected this argument based on three grounds. Firstly, Microsoft ignored the independent suppliers of the tied product and solely highlighted the conduct of other vendors of the tying product. Secondly, the vendors referred to by Microsoft do not tie their own media players to the operating systems but media players offered by individual suppliers. In the Commission's view, this only enhances the image of separate products. Thirdly, in all of the presented cases the media player could be uninstalled which was not the case with WMP.¹⁶⁷

¹⁶⁴ *Microsoft*, paras 805-806, 810 and 813.

¹⁶⁵ *Microsoft*, paras 811-812.

¹⁶⁶ *Microsoft*, paras 815-820.

¹⁶⁷ *Microsoft*, paras 821-823.

As a conclusion, the Commission confirmed that client PC operating systems and media players were indeed separate products and as such could be subject to tying within the meaning of Article 82 EC.¹⁶⁸

4.3 No Version of Windows without WMP

The third element of tying contrary to Article 82 as presented by the Commission was unavailability of untied supply. Microsoft deprived its customers of the choice of purchasing Windows without WMP by not providing any version of the operating system that did not include the streaming media player.¹⁶⁹ As a result of the licensing model employed by Microsoft, the OEMs were forced to licence Windows with WMP pre-installed. If OEMs or end-customers wished to install an alternative media player, this had to be installed in addition to the WMP since there was no ready technical means of un-installing the player. Microsoft's reason for the inability to un-install was that other parts of Windows and various third party products relied on WMP for proper functioning.¹⁷⁰

According to Microsoft, Article 82 (d) was inapplicable since the customers did not need to pay any extra cost for the WMP and they did not need to use the functionality provided but could use an alternative media player.¹⁷¹ The Commission firmly rejected the view that payment for the tied product was a necessary element in the assessment of competitive harm caused by tying. It furthermore discarded the argument that tying within the meaning of Article 82 required customers to be forced to use the tied product. However, whether or not WMP was *likely* to be used at the expense of competing products was considered a relevant factor when assessing possible foreclosure of competition. The Commission concluded that alternative suppliers of media players were at a competitive disadvantage as Microsoft's practice affected the structure of competition in the market for media players.¹⁷²

So long as customers automatically attained WMP, the Commission concluded that the third element of tying was fulfilled and declared that it was immaterial whether or not customers were forced to pay or use the product.¹⁷³

4.4 The Tie Foreclosed Competition in the Market for Media Players

The fourth element of abusive tying established by the Commission was that the tie produced a harmful effect on competition. Microsoft's interpretation of Article 82 was that 'forced use' was a necessary component of abuse. However, according to case law it suffice that a dominant undertaking

¹⁶⁸ *Microsoft*, para.825.

¹⁶⁹ *Microsoft*, para.826.

¹⁷⁰ *Microsoft*, paras 827 and 829.

¹⁷¹ Microsoft's submission of 17 October 2003, on page 20f.

¹⁷² *Microsoft*, paras 831-833.

¹⁷³ *Microsoft*, paras 833-834.

through direct or indirect tying deprives its customers of free choice and denies market access for other producers.¹⁷⁴ The Commission emphasized that Article 82 as part of Community law must be read in the light of its underlying objective, i.e. to ensure undistorted competition in the internal market.¹⁷⁵ As a result, Article 82 prohibits indirect tying which produces the same exclusionary effects as direct tying.¹⁷⁶

Recent case law further asserts that the foreclosure effect needs not to be complete but equally not insignificant,¹⁷⁷ and that concrete foreclosure effects must not necessarily be shown if it can be established that the relevant behaviour may have such an effect.¹⁷⁸

According to the Commission, Microsoft's tying of WMP was abusive because it made the media player the platform of choice for complementary content and applications in a manner which risked foreclosing competition in the media player market. This in turn, had spill-over effects on the competitive environment in related product markets such as the market for media encoding, management software and client PC operating system. Therefore, the Commission argued, that the tie did create a serious risk of foreclosing competition while at the same time restraining innovation.¹⁷⁹

4.4.1 Unparalleled Ubiquity

Microsoft's tying of WMP guaranteed that the media player was as ubiquitous on the market as Windows. In 2002, 121 million client PC operating systems were distributed around the globe – 114 of these had a version of Windows pre-installed. No other distribution mechanism was as effective as the one controlled by Microsoft.¹⁸⁰ The Commission concluded that when consumers purchased Windows with pre-installed WMP they were less likely to use an alternative player, especially since many of the equivalent third-party media players were not free of charge.¹⁸¹ While acknowledging the fact that many users value a pre-installed media player, the Commission rejected Microsoft's tying practice as a necessary prerequisite to achieve this benefit. If OEMs would pre-install a media player chosen by the specific customer this too would create comparable consumer benefits.¹⁸²

Next, the Commission considered whether WMP's ubiquity could be counterbalanced by alternative distribution channels suggested by Microsoft, such as installation agreements with OEMs or downloading over the internet. With regards to installation agreements with OEMs, the Commission established that this was a less effective distribution mechanism in comparison with tying WMP. Partly because not only the big

¹⁷⁴ *Hoffmann-La Roche*, paras 98, 90 and 111.

¹⁷⁵ See Article 3 (g) of the Treaty.

¹⁷⁶ *Microsoft*, para. 836.

¹⁷⁷ Case T-65/98 *Van den Bergh Foods Ltd v Commission* [2003] ECR II-4653, paras 149 and 160.

¹⁷⁸ Case T-219/99, *British Airways v. Commission* [2003] ECR II-5917, para. 293.

¹⁷⁹ *Microsoft*, para. 841.

¹⁸⁰ *Microsoft*, paras 843 and 844.

¹⁸¹ *Microsoft*, paras 845 and 847.

¹⁸² *Microsoft*, para. 848.

OEMs but also the smaller more dispersed OEMs were important players on the market. Additionally, the installation agreements with OEMs normally only covered computers sold to home users and not the sales to business users and large enterprises. Moreover, the tying practice discouraged OEMs to distribute PCs with third party streaming media players installed because users were unwilling to pay for a functionality that was offered for free by Microsoft. Other reasons behind OEMs' unwillingness to distribute additional media players related to increased expenses in customer support and higher testing costs.¹⁸³

In relation to downloading media players over the internet, the Commission acknowledged that this was the most important alternative distribution method. Still, downloading was not comparable to pre-installation of WMP for several reasons. Primarily because downloading offered a possibility to add a second media player while the WMP remained pre-installed. The Commission concluded that guaranteed distribution was important in situations of limited resources but more importantly, complementary content and applications were more likely to be developed for WMP due to its guaranteed ubiquity.¹⁸⁴ In addition, downloading was not an equally effective method of distribution because many users considered downloading as rather complicated in comparison to using a pre-installed media player.¹⁸⁵ A supply-side effect considered by the Commission was that, while distribution over the internet was inexpensive, the vendors still had to invest money to convince end-users to download its media player and not pre-install WMP.¹⁸⁶ As a result of the above considerations, the Commission concluded that downloading was an inadequate alternative to pre-installation and would not counterbalance the anticompetitive effects on competition resulting from Microsoft's tying practice.¹⁸⁷

Finally, the Commission assessed other alternative distribution channels, such as bundling media players with internet access services or other software but concluded that none of these distribution channels offset the effects of tying WMP with Windows.¹⁸⁸ Thus, according to the Commission, none of the distribution methods mentioned above were able to match the ubiquitous and guaranteed distribution of WMP.

4.4.2 Considerations of Content Providers and Software Developers

The Commission highlighted installation and usages shares as decisive factors when content providers and software developers decided upon which technology to use in the development of complementary software. For example, once encoded in WMP format, the complementary software could only be played back on a different media player if a licensing agreement

¹⁸³ *Microsoft*, paras 849-852.

¹⁸⁴ *Microsoft*, paras 859-863.

¹⁸⁵ *Microsoft*, para. 866.

¹⁸⁶ *Microsoft*, para. 870.

¹⁸⁷ *Microsoft*, para. 871.

¹⁸⁸ *Microsoft*, paras 872-876.

was concluded with Microsoft. Since the distribution of WMP was unparalleled, Microsoft had created a positive feedback loop.¹⁸⁹

The Commission established that content providers usually selected a single technology in which to encode their content thus producing savings in development, infrastructure and management costs. The natural choice in such a position was to decide upon a technology, such as the WMP, that maximized the reach of the product to end users. Moreover, a pre-installed media player allowed for direct contact with users without prior installation.¹⁹⁰ Hence, Microsoft's tying arrangement rendered WMP a smart choice for content providers who wanted to assert that they reached a wide audience. But this competitive advantage was, according to the Commission, a result of WMP's ubiquity and unrelated to the merits of the media player.¹⁹¹

The same line of reasoning was presented by software developers. They stated that they would save costs by writing to a single platform that made their products available to many users. Consequently, there was greater incentive to write applications relying on WMP functionality since this media player was distributed with every Windows client PC operating system.¹⁹²

The Commission was furthermore alarmed by the spill-over effects created by Microsoft's practice. The tying of WMP with Windows encouraged the uptake of Microsoft's server-software and formats and would ultimately influence complementary business areas, for example media players on wireless information devices and on-line music delivery. The Commission concluded that if Microsoft continued to tie WMP with Windows, the network effects mentioned would strengthen Microsoft's position in the market for media players. If the company was to become dominant in the media player market, its proprietary codecs and formats would present serious entry barriers not only in the relevant market but additionally in the markets using streaming media technologies.¹⁹³

4.4.3 Progress in the Media Player Market

Regarding the market development in media players, the Commission's 2003 market enquiry and the market surveys commissioned by Microsoft and individual market analysts, all indicated the same results.¹⁹⁴ However, there was no established methodology employed when assessing the data why the result shifted to some extent. In relation to the different media players, the Commission focused on WMP, Real(One) Player and QuickTime because they have comparable characteristics to WMP. Some of the other media players lacked streaming capabilities, relied upon third party proprietary media formats or were not active in the sale of server encoding or transmission software. Since the media player market was multifaceted,

¹⁸⁹ *Microsoft*, paras 879 and 881-882.

¹⁹⁰ *Microsoft*, paras 883 and 885.

¹⁹¹ *Microsoft*, para. 891.

¹⁹² *Microsoft*, paras 892 and 895.

¹⁹³ *Microsoft*, paras 897 and 899.

¹⁹⁴ *Microsoft*, para. 900.

the Commission analysed the data from different angles – namely, media player usage, format usage and format encoding.¹⁹⁵

Real Player was the most popular player on the market until the second quarter of 1999, i.e. before Microsoft started to tie its streaming media player with Windows. Real Player had nearly double the average number of monthly users compared to WMP, whereas QuickTime had about the same as WMP. Furthermore, WMP was receding in comparison to both Real Player and QuickTime.¹⁹⁶ In contrast, after Microsoft started tying WMP with Windows in May 1999, the average number of monthly users increased significantly. From the second quarter of 1999 to the second quarter of 2002, the total number of WMP users increased by 39 million which was equal to the combined increase of RealPlayer and QuickTime users.¹⁹⁷ However, Microsoft contested these numbers provided by Media Matrix on the basis that different methodologies were used when analysing the data.¹⁹⁸ Still, the data provided by Synovate on Microsoft's behalf and the Internet Applications Report demonstrated the same trend.¹⁹⁹

Format usage was examined as a complementary indicator of the development in the market for media players. Increased usage of Windows Media formats confirmed the trend in favour of usage of WMP.²⁰⁰ However, Microsoft provided additional data concerning media formats used on web sites. In an effort to refute the perception of significantly increased usage of formats provided by Microsoft, the company presented Netcraft data displaying how RealNetworks' formats remained the most common format on the web. However, due to the methodological deficiencies of the study and the fact that Microsoft's analysis contradicted all previously presented data, the Commission did not find that the study was incompatible with the conclusion that the development in the media player market illustrated a trend in favour of WMP usage.²⁰¹

4.4.4 “Competition on the Merits”

In Microsoft's view, the Commission failed to show that it was anticompetitive foreclosure on Microsoft's part which led to the decline of RealNetworks' market share in the media player market. Instead, Microsoft suggested that RealNetworks had reduced the appeal of its media player.

The Commission, however, was unconvinced by the evidence submitted by Microsoft in support of this report. Instead, all the data as well as the Commission's 2003 market enquiry indicated market foreclosure as a result of Microsoft's tying practice.²⁰²

The Commission acknowledged that it was not only the reach but also the quality of the product and licensing costs which influenced the choice of

¹⁹⁵ *Microsoft*, paras 902-904.

¹⁹⁶ *Microsoft*, para. 906.

¹⁹⁷ *Microsoft*, para. 907.

¹⁹⁸ *Microsoft*, para. 908.

¹⁹⁹ *Microsoft*, paras 918-920.

²⁰⁰ *Microsoft*, paras 931-933.

²⁰¹ *Microsoft*, paras 937-939 and 944.

²⁰² *Microsoft*, para. 947.

users and content providers. However, the Commission saw no evidence to show that RealNetworks had lost market shares due to product deficiency of its player or that WMP demonstrated better merits. Instead, reviews from the years 1999-2003, illustrated that RealNetworks' media player had received better ratings than WMP.²⁰³ Hence, nothing indicated that Microsoft's position in the market for media players was a result of better quality in its player. The Commission concluded that tying WMP with Windows, however, did place Microsoft in a unique and competitively advantageous position.²⁰⁴

4.5 Dismissal of Justifications put forth by Microsoft

Microsoft justified its tying of WMP by claiming that any anti-competitive effects from the tie would be offset by resulting efficiencies. The Commission concluded that this line of reasoning could have been examined under the separate product test, as the outcome of Microsoft's argumentation was that WMP and Windows no longer were separate products.²⁰⁵

4.5.1 Efficiencies

4.5.1.1 Distribution Efficiencies

Microsoft argued that tying WMP with Windows resulted in lowered transaction costs for consumer as a pre-installed set of default options limited both time loss and confusion. However, according to the Commission, Microsoft failed to distinguish between the advantages of obtaining a pre-installed media player along with the operating system and an automatic installation of WMP by Microsoft. On the contrary, potential transaction efficiencies might be higher if OEMs customized, loaded and configured applications onto client PCs to meet specific consumer demand. Hence, the Commission concluded that potential transactions efficiencies were not dependant on the tie of WMP.²⁰⁶

A separate argument put forth by Microsoft was that the tying of WMP reduced transactions costs as it did not need to maintain a separate distribution system for the tied product. The customers would equally save money by not having to do a second purchase and thus reduce costs in selection and installation of the tied product. The Commission rejected this defence since the distribution costs in software licensing were insignificant and did not compensate for the distortion of competition. At the same time, the Commission emphasized the importance of consumer choice and innovation.²⁰⁷

²⁰³ *Microsoft*, paras 947 and 948.

²⁰⁴ *Microsoft*, para. 951

²⁰⁵ *Microsoft*, para. 955.

²⁰⁶ *Microsoft*, paras 956 and 957.

²⁰⁷ *Microsoft*, para. 958.

Moreover, Microsoft stressed that it should not be placed in a disadvantaged position from a competitive point of view in comparison with other vendors of operating systems who also tied media players. What the company failed to recognise was that the other operating system vendors did not automatically tie its own media players with their operating systems. In addition, the Commission reminded Microsoft that its conduct as a dominant undertaking had a different impact on the market. Behaviour that was accepted when conducted by non-dominant players might very well be found abusive if adopted by a dominant company.²⁰⁸ In relation to tied sales, the Commission stated that even if tied sales were in accordance with commercial usage it might still be an abuse of Article 82 unless objectively justified by the dominant undertaking.²⁰⁹ In essence, in situations where technical integration by non-dominant undertakings do not creating adverse effects on competition, that same conduct if employed by a dominant undertaking may produce serious anti-competitive effects. In a competitive climate, market forces will compensate for potential restraints facing innovation whereas in a nearly monopolised market, innovation will suffer.²¹⁰

4.5.1.2 WMP as a Platform

Another efficiency claimed by Microsoft was that the tie allowed software developers to put all effort into their area of expertise and commercial interest. If the client PC operating system, in the present case Windows, provided media Application Programming Interface (API)²¹¹ this would facilitate the implementation of software functionalities. Hence, by integrating WMP with Windows, Microsoft argued that the value for end-users had increased.²¹² According to the Commission, Microsoft ‘has failed to supply evidence that tying of WMP is indispensable for the alleged pro-competitive effects to come into effect.’²¹³ In addition, the Commission established that the efficiencies were not distinct for the tie of WMP with Windows but could result from any bundle of operating system with media player. Furthermore, if WMP was pre-installed by OEMs rather than by Microsoft, the efficiencies would be the same.²¹⁴ The Commission also highlighted that not only WMP but also media players by other suppliers than Microsoft had contributed to the development in multimedia streaming technology and software applications. Hence, there was no evidence to show that software developers were only interested in placing calls to WMP. That a majority of the calls were placed to WMP reflected the tied product’s ubiquity rather than its indispensability for the claimed efficiencies.²¹⁵

The Commission once more highlighted the importance of undistorted competition to create efficiencies and a stimulate innovation. It concluded

²⁰⁸ *Microsoft*, paras 959 and 960.

²⁰⁹ In relation hereto, the Commission referred to *Tetra Pak II*, para. 37.

²¹⁰ *Microsoft*, para. 961.

²¹¹ Interfaces used by applications to call upon the services provided by an operating system, such as Windows; *Microsoft*, para. 38.

²¹² *Microsoft*, para. 962.

²¹³ *Microsoft*, para. 963.

²¹⁴ *Microsoft*, paras 963-965.

²¹⁵ *Microsoft*, paras 966-968

that the justifications relied on Microsoft's dominance in the tying market and not on the merits of WMP and as such, they were unconvincing. To sum up, the Commission stated that Microsoft had failed to provide sufficient evidence to support the alleged efficiencies and that the claimed benefits could be realized without tying WMP with Windows.²¹⁶

4.5.2 Lack of Incentives to Foreclose

According to Microsoft, the company did not have any motives to engage in abusive tying. It dismissed the notion that the tie of WMP was an effort to protect its monopoly position in the market for client PC operating systems. Microsoft found it unrealistic that a company would enter the client PC operating system market as a result of leveraged power in the market for media players.²¹⁷ The Commission recognised that media players were not ready substitutes for client PC operating systems but still emphasised that 'limited purpose' applications programs, such as media applications, could be written employing media player's APIs on a stand-alone basis. If limited platforms for applications were to expand in use, it would encourage the development of available APIs to accept the writing of applications for 'general purpose' and not solely for limited purposes. Moreover, middleware, for instance Java, combined with a media player could already constitute a substitute for general purpose platform. Hence, media players could be regarded as an indispensable element of an existing platform threat because of their technological and commercial potential in addition to the network effects present. Consequently, the Commission concluded that Microsoft did indeed have incentives to foreclose competition by tying WMP with Windows.²¹⁸

Yet another reason for Microsoft to engage in tying was that if the company became dominant in the market for media players, possible entrants in the market for client PC operating systems would have to supply media players that supported media technologies developed by Microsoft due to the indirect network effects described above (Section 4.1.3.2). Since content providers, developers and end-users would rely on WMP format this would increase the entry barriers in the tying market.²¹⁹ Moreover, the ubiquity of WMP on Windows PCs presented a strategic entry to related markets, such as online music delivery.²²⁰

As a conclusion, the Commission rejected the argument that Microsoft did not have any incentives to engage in anticompetitive tying.

4.6 In Conclusion

The Commission concluded that Microsoft tied WMP with Windows to ensure a guaranteed distribution method. This placed the company in an

²¹⁶ *Microsoft*, paras 969 and 970.

²¹⁷ *Microsoft*, para. 971.

²¹⁸ *Microsoft*, paras 972 and 973.

²¹⁹ *Microsoft*, para. 974.

²²⁰ *Microsoft*, para. 975.

extremely advantageous position in the market for media players, which was unrelated to the merits of its media player. In effect, potentially better media players were deprived of competing on the merits.²²¹ The tying practice produced serious anticompetitive effects by weakening effective competition in the media player market. For example, it deterred innovation not only in media players but also with regard to complementary technologies since producers feared that Microsoft might expand its tying practice to include additional products. Moreover, tying WMP with Windows in a market characterized by network effect has created high barriers to entry.²²² In its conclusion, the Commission emphasized ‘a reasonable likelihood’ of Microsoft’s behaviour resulting in lessened competition in a manner that would eliminate the chances of maintaining an effective competition structure in the near future. In light of the above, the Commission came to the decision that Microsoft, by tying WMP with Windows, had abused its dominant position in a way prohibited by Article 82 (d).²²³

According to the Commission, the abusive tying practice commenced in May 1999, when Microsoft started to tie its streaming media player with Windows 98 Second Edition. It was then that Microsoft started tying a product offered in the relevant market for streaming media players. This practice had continued with subsequent versions of Windows ever since.²²⁴

²²¹ *Microsoft*, para. 979.

²²² *Microsoft*, paras 980-983.

²²³ *Microsoft*, para. 984.

²²⁴ *Microsoft*, para. 985.

5 Effects on EC Competition Law

The decision in *Microsoft* has fuelled the debate surrounding Article 82 and its future position in EC competition law. While the DG Competition discussion paper further elaborated on the issue of tying, guidelines in relation to Article 82 is yet to be drafted. Since the Decision represents the Commission's view on how to assess tying, perhaps the case provides us with a glance of what is to come. Still, the Commission may want to be more lucid in its considerations as the views on the Decision's impact on EC competition law differ widely. The *Microsoft* case has also been subject to much critique, some of which is recapitulated at the end of this Chapter.

5.1 The Legal Status of Tying

As mentioned previously, prior to *Microsoft* tying was subject to *per se* prohibition. Since tying as such was considered unlawful, the Commission and the Community Courts did not evaluate the possible competitive effects on a case-by case basis.²²⁵ However, in *Microsoft* the Commission applied four separate criteria in order to determine whether the tying arrangement employed by the company was prohibited under Article 82 (d). The novelty in the assessment of tying was the presence of a condition concerning the foreclosure effect. Hence, an evaluation of the competitive effects resulting from the tying arrangement was needed. This altered method of assessment has since stirred a lively discussion concerning the legal status of tying. Is tying continuously prohibited *per se*; is it subject to a modified *per se* illegality test or has a rule of reason similar to the one applied in the *US Microsoft* case²²⁶ been adopted? The opinions differ.

5.1.1 Rule of Reason Approach

According to the Commission Press Release of 24 March 2004, the Commission 'has followed a 'rule of reason' approach to establish whether the anti-competitive effects of tying outweigh any possible pro-competitive benefits.'²²⁷ It further stated that the applied framework for tying cases was the same as described by the Court of Appeals in *US v. Microsoft*.

According to the D.C. Circuit Court of Appeals, a rule of reason approach generally consisted of four steps: 'First, to be condemned as exclusionary, a monopolist's act must have an 'anticompetitive effect'. That is, it must harm the competitive *process* and thereby harm consumers. In contrast, harm to one or more *competitors* will not suffice. Second, the

²²⁵ GCLC Research Papers, p.177 and 185f.

²²⁶ *Supra* note 4.

²²⁷ Commission Press Release of 24 March 2004, MEMO/04/70, <http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/04/70&format=HTML&aged=1&language=EN&guiLanguage=en> last visited 4 January 2007

plaintiff, on whom the burden of proof of course rests, must demonstrate that the monopolist's conduct indeed has the requisite anticompetitive effect. Third, if a plaintiff successfully establishes a prima facie case under § 2 by demonstrating anticompetitive effect, then the monopolist may proffer a 'procompetitive justification' for its conduct. If the monopolist asserts a procompetitive justification - a nonpretextual claim that its conduct is indeed a form of competition on the merits because it involves, for example, greater efficiency or enhanced consumer appeal-then the burden shifts back to the plaintiff to rebut the claim. Fourth, if the monopolist's procompetitive justification stands un rebutted, then the plaintiff must demonstrate that the anticompetitive harm of the conduct outweighs the procompetitive benefit.²²⁸

A statement by Commissioner Monti on 24 March 2004, further emphasized that the Commission had not ruled that tying was illegal *per se* but instead developed an analysis to assess the actual impact of Microsoft's tying practice in addition to its alleged efficiencies. He accentuated that the Commission had indeed 'used the rule of reason although we don't call it like that in Europe.'²²⁹

5.1.2 Modified *per se* Illegality Test

In contrast, Evans and Padilla²³⁰ argue that the Commission did not apply the rule of reason approach adopted by the US Court of Appeals but instead what resembles the modified *per se* illegality test that was rejected by the same Court.²³¹ The modified *per se* illegality test was first adopted by the US Supreme Court in *Jefferson Parish*²³² and consisted of four steps: '(1) the tying and the tied goods are two separate products; (2) the defendant has market power in the tying product market; (3) the defendant affords consumers no choice but to purchase the tied product from it; and (4) the tying arrangement forecloses a substantial volume of commerce.'²³³ In the *US Microsoft* case this approach was rejected on the basis that its consumer demand test would 'chill innovation to the detriment of consumers by preventing firms from integrating into their products new functionality previously provided by standalone products-and hence, by definition, subject to separate consumer demand.'²³⁴ Evans and Padilla illustrate the contrasts between the rule of reason approach adopted by the US Court of Appeals and the, according to them, modified *per se* illegality test applied by the Commission. For example, the Commission relied on the consumer demand test to demonstrate separate products although this was criticized in the US judgment. Moreover, it imposed a heavy burden on Microsoft to show efficiencies and to illustrate how the pro-competitive benefits

²²⁸ *US v. Microsoft*, paras 95-97.

²²⁹ Statement by Mario Monti of 24 March 2004, No. 47/04, <http://www.eurunion.org/news/press/2004/20040047.htm> last visited 4 January 2007.

²³⁰ *Supra* note 66.

²³¹ Evans and Padilla, p.6.

²³² *Jefferson Parish Hospital District No 2 et al. v. Hyde*, 466 U.S. 2 (1984).

²³³ *US v. Microsoft*, para. 85.

²³⁴ *US v. Microsoft*, para. 89.

outweighed the anti-competitive effects. If the US rule of reason approach would have been used it would have placed a modest burden on Microsoft to show efficiencies and no burden to demonstrate how the anti-competitive effects outweighed the pro-competitive benefits.²³⁵

5.1.3 *Per se* Prohibition

Nalebuff²³⁶, on the other hand, while supporting the outcome of the Decision, disagrees with the Commission in terms of which approach is the most appropriate one to address tying. Nalebuff does not favour a rule of reason approach but instead suggests that tying by a dominant undertaking must be subject to a *per se* prohibition also in future tying cases. At least, in cases where the foreclosure is significant and it is confirmed that the monopolist could have reasonably understood the effects of its tying practice.²³⁷ Thus, Nalebuff argue that when a monopolist engages in unreasonable tying this ‘is and should remain a *per se* violation’.²³⁸

5.2 Protect Competition not Competitors

Another issue brought to light by the Decision was the question of *who* Article 82 is meant to protect. Is the aim of the provision to protect consumers, individual competitors or competition at large?

Commissioner Monti made a clear-cut statement in reference to this matter, emphasizing that the main objective of EC competition law is indeed to enhance consumer welfare and that ‘only a very poorly informed observer can still resort to the catchphrase that the main goal of competition law in Europe is a different one, such as protecting competitors.’²³⁹ This was also accentuated by Commissioner Kroes, who stressed that according to the Commission, the goal of Article 82 is to protect competition as a way to enhance consumer welfare and ensure efficient allocation of resources. She further expressed that it is competition and not competitors that should be protected to reach the ultimate aim of avoiding consumers harm. In her own words: ‘I like aggressive competition – including by dominant companies – and I don’t care if it may hurt competitors – as long as it ultimately benefits consumers.’²⁴⁰

²³⁵ Evans and Padilla, p.8.

²³⁶ Barry Nalebuff, *Tied and True Exclusion*, Competition Policy International, Spring 2005, Vol.1, No.1, p.41-53 [hereinafter: *Nalebuff: Tied and True Exclusion*], http://papers.ssrn.com/sol3/papers.cfm?abstract_id=702646#PaperDownload last visited 4 January 2007.

²³⁷ Nalebuff: *Tied and True Exclusion*, p.49 and 53.

²³⁸ Nalebuff: *Tied and True Exclusion*, p.53.

²³⁹ Mario Monti, *A Reformed Competition Policy; Achievements and Challenges for the Future*, Speech at Center for European Reform, Brussels, 28th October 2004, <http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/04/477&format=HTML&aged=0&language=EN&guiLanguage=en> last visited 4 January 2007.

²⁴⁰ Neelie Kroes, Member of the European Commission in charge of Competition Policy, *Preliminary Thoughts on Policy Review of Article 82*, Speech at the Fordham Corporate Law Institute, New York, 23rd September 2005, SPEECH/05/537

Microsoft,²⁴¹ on the other hand, claims that the Commission, far from upholding a rule of reason analysis, based its Decision on the alleged adverse impact of one single competitor – RealNetworks. Hence, according to Microsoft, the Commission’s conclusion did not reflect an effort to protect competition from harm but rather to protect a single competitor.²⁴² A similar view is presented by Hahn²⁴³ who expresses that unlike the American courts, the Commission and the Community Courts still hold competition as an end in itself. This is illustrated by *Microsoft* in which competitors is protected from the existing competition in the market. In an effort to level the playing field, the Commission protected competitors to the detriment of not only Microsoft but consumers as well. The decided remedies could render Windows less dependable as a platform for applications software resulting in slower and more complex programs. Moreover, the Decision opens the door for numerous claims against Microsoft since the media playing software is not fundamentally different from other software tied to Windows. If Microsoft would have to redesign its entire client PC operating system this would not only impact Microsoft but all software applications which rely on Windows. Hence, according to Hahn, the Decision ‘casts a long shadow over the software industry’.²⁴⁴

5.3 Innovation

The U.S. Assistant Attorney General Pate similarly criticized the Commission’s Decision stating that ‘imposing antitrust liability on the basis of product enhancement [...] may produce unintended consequences. Sound antitrust policy must avoid killing innovation and competition even by dominant companies. A contrary approach risks protecting competitors, not competition, in ways that may ultimately harm innovation and the consumers that benefit from it.’²⁴⁵

However, the contrary view was presented by Steve Houck during an ABA panel discussion.²⁴⁶ He suggests that the Decision is in fact pro-innovation and protects competitors’ as well as Microsoft’s intellectual property rights. He argues that the Decision does not prevent Microsoft

<http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/05/537&format=HTML&aged=0&language=EN&guiLanguage=en> last visited 4 January 2007.

²⁴¹ Microsoft Corporation, *The European Commission’s Decision in the Microsoft Case and its Implications for Other Companies and Industries*, April 2004 [hereinafter: *Microsoft Corp.*] <http://download.microsoft.com/download/5/2/7/52794f65-8784-43cf-8651-c7d9e7d34f90/Comment%20on%20EC%20%20Microsoft%20Decision.pdf> last visited 4 January 2007.

²⁴² Microsoft Corp., p.6.

²⁴³ Robert W. Hahn, *The Microsoft case: lessons from Europe*, April 2004 [hereinafter: *Hahn*] <http://www.aei-brookings.org/policy/page.php?id=180> last visited 4 January 2007.

²⁴⁴ Hahn, p.1.

²⁴⁵ Statement by U.S. Assistant Attorney General for Antitrust R. Hewitt Pate, 24 March 2004, http://www.usdoj.gov/atr/public/press_releases/2004/202976.htm last visited 4 January 2007.

²⁴⁶ American Bar Association (2004), *The EC Decision Against Microsoft: Windows on the World, Glass Houses, or Through the Looking Glass?*, September 2004 [hereinafter: *ABA 2004*] <http://www.abanet.org/antitrust/at-source/04/09/Sep04MSBB.pdf> last visited 4 January 2007.

from offering a tied version of Windows as long as an untied version is also on the market. Furthermore, Houck implies that Microsoft's integration of WMP in Windows is a limited and derivative form of innovation since the original products were invented by someone other than Microsoft. He agrees with the Commission in that the indirect networks effect resulting from Microsoft's tying practice threatened innovation.²⁴⁷

Ayres and Nalebuff,²⁴⁸ also support the Commission's finding of an antitrust violation in *Microsoft*. According to them, the Decision has significant implications on future developments in the world of digital media. The most serious concern was that Microsoft would use its dominant position in the client PC operating system market to eliminate competition in the media player market thus creating a monopoly therein. The potential consequences included reduced incentives for innovation, setting the wrong standard and inefficiencies stemming from a monopolized market. Since most media streams are encoded in Microsoft's proprietary WMP format, effective competition in the player market is essential for the future progress in digital media. If not, Ayres and Nalebuff argue, Microsoft's dominant position will expand into the encoding market and the WMP format will become the standard format.²⁴⁹ In addition, the Commission's position is important not only with reference to streaming media players in PCs but as the trend of digital media continues; alternative platforms will become increasingly important.²⁵⁰

5.4 The Critics

The Commission's decision in *Microsoft* has been subject to much critique, both by legal scholars and practitioners. This Section provides an abstract of some of the argued deficiencies with the case. Firstly, the Commission has been criticised for employing the consumer demand test to establish separate products although this test is not, as the Commission itself concluded,²⁵¹ ideal. Moreover, the standard and burden of proof applied by the Commission is suggested to be unsatisfactory - both relating to the 'indispensability' criterion employed in relation to efficiencies and regarding the display of harm to competition. Finally, criticism of the concept of 'competition on the merit' has surfaced. In the absence of a clear explanation, this concept does not seem to provide much operational guidance as to what conduct constitutes abuse as oppose to use of a dominant position.

²⁴⁷ ABA 2004, p.11.

²⁴⁸ Ian Ayres, Barry Nalebuff, *Going Soft on Microsoft? The EU's Antitrust Case and Remedy*, *The Economists' Voice*, Volume 2, Issue 2, 2005 [hereinafter: Ayres and Nalebuff] <http://www.whynot.net/main/goingsoftmicrosoft.pdf> last visited 4 January 2007

²⁴⁹ Ayres and Nalebuff, p. 3f.

²⁵⁰ Ayres and Nalebuff, p. 1.

²⁵¹ *Microsoft*, para.808.

5.4.1 Consumer Demand Test

Evans and Padilla²⁵² criticise the Commission for applying a consumer demand test in *Microsoft*. They correctly argue that the established EC case law only refers to situations where the tying and the tied products are physically distinct and thus not cases of technical tying which is the situation in *Microsoft*. The consumer demand test employed in the Decision concludes that the tying product and the tied product are separate products if there is separate demand for the tied product. According to Evans and Padilla, the consumer demand test produces absurd results. For example, shoes with laces are not viewed as a single product, since there are vendors who develop and supply these products separately. In addition, whenever there is an aftermarket of spare parts relating to a product, the test excludes the definition of a single product.²⁵³ Moreover, they argue that the test fails to capture the anticompetitive effects of tying. The Commission established that Microsoft engaged in tying since it did not offer the tying product without the tied product. However, in a case where there is no material demand for the tying product alone, the failure to provide the same cannot produce any competitive effects. Such effects will only come about where the tie consists of products for which there exist separate material demand for both. In order to remove cases such as shoes with shoelaces from the equation, Evans and Padilla suggest a test that measures material demand for the tying product. By not investigating the existence of material demand for Windows without WMP, the Commission could not possibly assert whether the absence of such an offer foreclosed competition or in fact represented normal commercial conduct that generated pro-competitive benefits. Evans and Padilla conclude that the Commission did not apply settled EC tying law but instead extended the law to include products made up of components and products with technically integrated features.²⁵⁴

Ahlborn, Bailey and Crossley,²⁵⁵ similarly question the Commission's interpretation of the separate products test and highlight the same problems as Evans and Padilla. They suggest that a better interpretation of the separate products test was adopted in *Jefferson Parish*,²⁵⁶ in which significant consumer demand was required in both the tied and the tying products. They also criticise the lack of policy rationale behind the Commission's interpretation of the test. A general problem with the separate products test is that it focuses on past customer and supplier behaviour. Hence, firms engaging in new and innovative product integration risk being found guilty of illegal tying if there are less innovative firms in the market which continue to offer the products separately.²⁵⁷

²⁵² *Supra* note 66.

²⁵³ Evans and Padilla, p. 9.

²⁵⁴ Evans and Padilla, p. 10.

²⁵⁵ GCLC Research Papers.

²⁵⁶ *Supra* note 232.

²⁵⁷ GCLC Research Papers, p. 210.

5.4.2 Standard and Burden of Proof

Furthermore, Ahlborn, Bailey and Crossley criticize the Commission's approach concerning the standard of proof when establishing efficiencies. They argue that the standard of proof should be in proportion to the countervailing harm facing competition. Hence, a balanced approach, which considers both efficiency gains and harm to competition, is suggested. They are critical towards the 'indispensability' criterion applied by the Commission in relation to Microsoft's efficiency claims. The Commission concluded that 'Microsoft has failed to supply evidence that tying of WMP is indispensable for the alleged pro-competitive effects to come into effect.'²⁵⁸ The standard of proof required by the Commission move the focal point from the question whether the tying practice is welfare enhancing and instead focuses on whether the relevant efficiencies could be achieved by less restrictive means. According to Ahlborn, Bailey and Crossley, this approach risks eliminating welfare enhancing tying practices and chill technological innovation. Instead, they suggest a shift in the burden of proof. The dominant undertaking should continuously have the burden to present compelling evidence of the alleged efficiencies but thereafter the competition authorities should demonstrate whether the anti-competitive effects outweigh the established efficiencies and if the efficiencies could have been achieved using less restrictive means.²⁵⁹

Ahlborn, Bailey and Crossley also criticize the requisite standard of proof with reference to the harm to competition. They argue that the Commission's conclusion of 'a reasonable likelihood'²⁶⁰ that Microsoft's tying practice would result in lessened competition is not a satisfactory standard of proof. Instead of a balance of probabilities standard, they argue that the Commission should apply a similar standard as in merger cases. Hence, before deciding on abusive tying, concrete and convincing evidence must assure the Commission at a high level that the conduct will likely produce significant anti-competitive effects.²⁶¹ Moreover, they emphasize that to the extent a case rely on speculative prediction of future loss of competition, higher evidentiary requirements are needed. To support this argument Ahlborn, Bailey and Crossley cite the CFI in *Tetra Laval* where the Court decided that since the predicted dominant position would materialize only after a some time, the analysis had to be 'particularly plausible'.²⁶²

5.4.3 The Notion of 'Competition on the Merits'

The Commission has furthermore been criticized for employing the notion of 'competition on the merits' when deciding upon the foreclosure effect of

²⁵⁸ *Microsoft*, para. 963.

²⁵⁹ GCLC Research Papers, p. 214-215.

²⁶⁰ *Microsoft*, para. 984.

²⁶¹ GCLC Research Papers, p.211 and 215.

²⁶² Case T-5/02 *Tetra Laval BV v. Commission* [2002] E.C.R. II-4381, at para.162.

Microsoft's tying arrangement.²⁶³ While it is hard to argue against 'competition on the merits', the Decision does not give any further guidance as to the meaning of the phrase in the context of EC competition law. The Commission also failed to provide an explanation as to what kind of competition is to be viewed as 'on the merits'. Consequently, some argue that the concept is unsuitable as part of an operational test to differentiate between normal business practices and abusive conduct by dominant undertakings.²⁶⁴ Did the Commission mean to imply that 'competition on the merits' is incompatible with an undertaking using its dominant position in one market to gain benefits in a second market? If so, what would then differentiate use of dominant position from abuse of the same? Thus, in the absence of a rational explanation as to what 'competition on the merits' entail, the phrase does not provide any effective guidance on what sort of behaviour that constitutes abuse rather than use of a dominant position.²⁶⁵

²⁶³ Reckon Open, *Microsoft: The EC Abuse of Dominance Case*, [hereinafter: *Reckon Open*] http://www.reckon.co.uk/open/Microsoft:_the_EC_abuse_of_dominance_case last visited 4 January 2007

²⁶⁴ Reckon Open, p.9.

²⁶⁵ Reckon Open, p.10.

6 Analysis

6.1 *Microsoft* and its Implications

The ambition of this thesis was to provide a window into the complex and extensive decision in *Microsoft* in an attempt to elucidate the legal status of tying in EC competition law. The thesis is anchored in a series of questions formulated in the introduction - questions that are now reviewed to consider *Microsoft* and its implications.

The first two questions related to the Commission's assessment of abusive tying and possible deviation from earlier case law. As Chapter 3 reveals, the Decision does reflect a modified structure of analysis in which the Commission departs from the prior *per se* prohibition of tying in favour of a more effects-based approach. While Nalebuff argues that some tying practices remain prohibited *per se*, it seems clear that at least cases of technical tying has left the *per se* prohibition zone. This conclusion can be drawn from the introduction of the foreclosure-element - a condition that necessitates an analysis of the competitive effects of the tie. Under a *per se* rule, the assessment of effects is unnecessary since tying as such is prohibited. Another strong indicator of this conclusion is the statement by Commissioner Monti as he explicitly expressed that the Commission did not rule that tying was prohibited *per se*. In contrast, both the statement by Commissioner Monti as well as the Commission Press Release on the 24 March 2004 emphasized that the new approach was no different from the 'rule of reason' approach adopted in the *US Microsoft* case. However, as the critics have stressed, numerous factors differentiate the Commission's approach from the US 'rule of reason' approach - for instance, the use of the consumer demand test and a different standard and burden of proof. Instead, the four elements of abusive tying as portrayed in the Commission's analysis are very similar to the criteria presented in the modified *per se* illegality test which was rejected in the *US Microsoft* case. The criterion of separate products was present in both instances as was the prerequisite of a foreclosure effect. While the modified *per se* illegality test required market power in the tying market, the Commission required a dominant position in the tying market. Finally, the unavailability of untied supply in *Microsoft* was matched by no choice but to purchase the tied product in the modified *per se* illegality test. In addition, while the consumer demand test was rejected under the 'rule of reason' approach, it was present in the modified *per se* illegality test. Thus, even though the introduction of the foreclosure effect criterion brings the EC approach a step closer to the 'rule of reason approach' adopted in the US, several aspects are still separating the two methods of assessment.

The next question posed in the introduction concerns the material facts of the case, i.e. why did the Commission find Microsoft guilty of infringing Article 82 (d)? In Chapter 4, both the material facts and the findings of the Commission are presented, revealing how the Commission reasoned in relation to the four elements introduced in the preceding Chapter. However,

to avoid a lengthy summary of this 302-pages-long case, Chapter 4 in itself will illustrate the conclusions in this part.

Finally, the last question of the introduction related to the effects of *Microsoft* from an EC competition law perspective in addition to the main objections against the Decision. While the legal status of tying as discussed in Chapter 5 have already been addressed, some of the criticism facing the Decision is further examined below; in relation hereto my personal views on the issues are also presented.

Some of the criticism put forth by Ahlborn, Bailey and Crossley refer to the standard and burden of proof applied in *Microsoft*. They argue that the high evidentiary requirements on the dominant undertaking, such as the 'indispensability' criterion employed in relation to efficiencies, demonstrates that the Commission failed to balance the pro-competitive benefits and anti-competitive effects in a manner similar to the 'rule of reason' approach. In my view, the criterion seems to represent a notion that the dominant undertaking must choose the least restrictive alternative to achieve the pro-competitive benefits. While the idea is noble, it may not be realistic in the face of the relevant market conditions or even an alternative that the dominant undertaking wishes to engage in. By not recognizing the full potential of the pro-competitive benefits of tying, the Commission risks rejecting tying arrangements that would have enhanced consumer welfare. While the use of a least restrictive method may render the end-result in each individual case more pro-competitive due to less anti-competitive effects, this method will also reject tying arrangements that would have produced a surplus of pro-competitive benefits. Thus, the Commission discards pro-competitive tying practices in favour of less restrictive alternatives that are only theoretical and may never take place. Hence, on the basis that the surplus of beneficial effects is less significant, the Commission so chooses to disallow the tie and sacrifice the associated benefits. This is, in my view, a rather strange logic. Thus, along with Ahlborn, Bailey and Crossley, I argue in favour of a balancing-test where the anti-competitive effects are weighed against the pro-competitive benefits in a manner similar to the US 'rule of reason' approach. Thus, considering that a balancing test would tolerate *all* tying arrangements with a pro-competitive result - this approach would enhance consumer welfare at large. In addition, the market environment would be less affected by interference from competition authorities.

Still, in my view, a 'rule of reason' approach in Europe would not necessarily produce the same outcome as in the US since the considerations may differ - this is where the objective of Article 82 becomes central. By balancing the anti-competitive effects and the pro-competitive benefits, the Commission and the Community Courts can decide on the weight of the different factors. For example, the protection of competition may weigh heavily as a valuable resource in the efforts to protect consumer welfare. In addition, future anti-competitive effects may be considered. Hence, the scale may decide in the final balancing test but the Commission and the Community Courts retain the power to decide how much weight should be put on to the scale. By exposing the weight of separate issues, the dominant companies can more easily foresee what course of actions that is contrary to

Article 82 (d) EC. While the Courts would still have a certain margin of appreciation, the burden of proof would have shifted. Thus, the dominant company would no longer have to prove the ‘indispensability’ of its actions but instead it would be for the Commission and the Courts to balance the pro-competitive benefits against the anti-competitive effects. In addition, by creating a sense of predictability, the innovative climate would benefit.

Apart from the criticism relating to the standard and burden of proof, the Commission was also criticized for using the consumer demand test to establish separate products. While acknowledging that the consumer demand test under a *per se* rule risked ignoring efficiency benefits from new product integration, the Commission excluded the risk in *Microsoft* since there remained non-insignificant consumer demand four years after the company’s tying practice had started. The DG Competition discussion paper similarly recognized the complexity of technical integration of new features. It concluded that the decisive factor was whether consumer demand had shifted to the extent where there was no independent demand for the tied product. By any measure, this is a relatively restrictive approach that risks reducing the incentives to innovate within dominant undertakings. This critique has also been presented by Ahlborn, Bailey and Crossley, who conclude that as the test focuses on past behaviour, innovative firms are at risk of being found guilty of illegal tying if less innovative firms continue to offer the products separately.

Additional detrimental effects as a result of the consumer demand test are also highlighted by Ahlborn, Bailey and Crossley, as well as Evans and Padilla. For example, products that consist of separate components for which there exist individual vendors can never be regarded as one product, nor can products for which there is an aftermarket of spare parts. In view of the consumer demand test, the criterion of separate products is always fulfilled in these cases. Admittedly, this produces rather strange consequences for dominant undertakings in the supply of these products. Evans and Padilla furthermore illustrate how the consumer demand test fails to capture the anti-competitive effects of Microsoft’s tie since few consumers will buy the tying product separate from the tied product. Thus, the tied version of Windows will remain ubiquitous on the market, the content providers and software developers will still reason in the same manner producing the same network effects, and the WMP format may still become the standard format. However, it can be argued that the end result is a question more closely related to the effectiveness of the chosen remedy and not directly related to whether Microsoft engaged in abusive tying by technically integrating separate products.

Still, while *Microsoft* established that the Commission views consumer demand as an indicator of separate products, it also acknowledged that the test is not infallible. Other factors, such as Microsoft’s own behaviour as well as industry structures, thus complimented the test before the Commission concluded that WMP and Windows were indeed separate products. A possible interpretation of this approach is that the consumer demand test alone does not satisfy the element of separate products.

6.2 Concluding remarks

The Commission's analysis in *Microsoft* illustrates a changed position with regards to the assessment of abusive tying. It does not, however, demonstrate an altered position concerning the illegality of abusive tying.

The Commission's approach towards tying remains rather unsympathetic as portrayed by the high evidentiary requirements on the dominant undertaking. While the adopted method of assessment represent a more effects-based approach that has moved away from the prior *per se* prohibition of tying – an approach similar to the US 'rule of reason' approach is not reflected in *Microsoft*. The economic aspects of tying are still underdeveloped in EC competition law.

A rather ambiguous feature of the EC approach towards tying is that while the practice is viewed with suspicion, very few tying cases have actually been brought before the Community Courts. In connection with technical tying, *Microsoft* is the only formal decision. As a consequence, it is difficult to determine whether the Commission's approach reflects a different approach towards tying at large or whether the considerations of the case are related to the specific circumstances therein, i.e. technical tying of software applications by an overwhelmingly dominant undertaking. In its Decision, the Commission does distinguish *Microsoft* from 'classical tying cases' in which the foreclosure effect is demonstrated by the tie itself. This separation of tying cases may indicate that the classical tying cases are still subject to *per se* prohibition under EC competition law. However, the DG Competition discussion paper does not limit the assessment of foreclosure effect to only encompass technical tying.

As a final note in this thesis, I assume it is appropriate to deliver my personal view on the outcome of the case. I argue that it was the method of assessing the tie that was flawed in *Microsoft*, not necessarily the conclusion. However, to assess the outcome of the case in the light of an approach similar to the US 'rule of reason' approach is another thesis altogether.

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