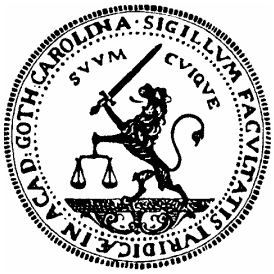

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The Interaction between European Community Competition Law and Intellectual Property Rights

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Tying and Bundling in the Light of the *Microsoft* Case

Master thesis
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Contents

Summary

European Community (EC) Competition Law and Intellectual Property Right (IPR) share the same basic objective of promoting consumer welfare and allocation of resources. However, potential conflicts arise owing to the means used by each system to promote their respective goals. Tying and bundling is one of these means, which IPR owners use as one way to exploit Intellectual Property (IP). Competition law, on the other hand, looks at tying and bundling with suspicious eyes.

This conflict between competition law and tying and bundling was evident in a recent set of cases, namely those brought against Microsoft in both the United States and the EU. In the light of these cases, the question of where to draw the line between anti-competitive and pro-competitive tying and bundling and the question of proper remedy against anti-competitive tying and bundling was examined.

Microsoft represents an important industry in our society today, namely the Information Technology (IT) or, more specifically, the software industry. This is a new kind of industry with features different from traditional industry. Due to this fact, one might think that we would see a new approach and new criteria of where to draw the line between anti-competitive and pro-competitive tying and bundling. Instead, an analysis of doctrines and case law on the area shows that the *Microsoft* judgement in Europe can be said to be consistent in being in line with the established case law in the field, *Hilti AG v. Commission* and *Tetra Pak International SA v. Commission*. However, these cases refer to tying and bundling within traditional industry and, as pointed before, the situation in Microsoft is dealing with software products and the software market. Tying software is part of the development of products within this line of business.

The approach against Microsoft in EU as portrayed by the high evidentiary requirements on Microsoft and the fact that the approach is consistent with established case law reflect a continued suspicious attitude towards tying and bundling.

The U.S. Court of Appeal, District Court of Columbia, however, shows a change in attitude towards tying and bundling as portrayed in Microsoft and its tying and bundling of Internet Explorer (IE) with Windows. However, a conclusive answer cannot be drawn from this case because the Supreme Court never ruled on the case. Until that happens, a per se rule applies to tying and bundling.

With regard to the question of proper remedy, a remedy that is not a disincentive to further innovation, there is no general correct answer, thus a case-by-case basis is necessary.

One can say that we are moving in the right direction, where there is a clear-cut line between anti-competitive and pro-competitive tying and bundling and where tying and bundling is seen with positive eyes. In other words, a rule of reason approach rather than a per se rule approach towards tying and bundling. Competition law must learn to cope with a new sort of economy where tying and bundling is a common feature.

Sammanfattning

Europeiska gemenskapens (EG) konkurrensrätt och immaterialrättsliga rättigheter delar samma grundläggande mål i att främja välfärd för konsumenter och allokera resurser. Likväl uppstår potentiella konflikter med anledning av medlet som används av respektive ordning för att främja deras respektive mål. Kopplingsförbehåll är ett av dessa medel som ägaren till en immaterialrättslig rättighet använder sig av för att utnyttja sin immateriella egendom. Konkurrensrätt, å andra sidan, ser på kopplingsförbehåll med misstänksamma ögon.

Denna konflikt var nyligen synbar i en del rättsfall, nämligen dem som fördes mot Microsoft både i USA och EU. I ljuset av dessa rättsfall undersöktes frågan om var gränsen skall dras mellan konkurrensfrämjande och konkurrensbegränsande och frågan om en lämplig åtgärd mot konkurrensbegränsande kopplingsförbehåll.

Microsoft står för en viktig industri i dagens samhälle, nämligen information och teknik, eller mer specifikt mjukvaruindustrin. Detta är en ny form av industri med annorlunda särdrag jämfört med den traditionella industrin. Mot bakgrund av detta skulle en kunna tro att vi skulle få se ett nytt förhållningssätt och nya rekvisit för var gränsen skulle dras mellan konkurrensbegränsande och konkurrensfrämjande kopplingsförbehåll. En analys av doktrinen och praxis på området visar att *Microsoft* domen i EU, kan sägas vara i linje med etablerad praxis på området, *Hilti AG v. Kommissionen* och *Tetra Pak International SA v. Kommissionen*. Dessa rättsfall åsyftar, emellertid, på kopplingsförbehåll inom den traditionella industrin och såsom påpekats tidigare så rör sig Microsoft om mjukvaru produkter och marknaden för den. Att koppla mjukvaror är en del av utvecklingen av produkter inom denna bransch.

Förhållningssättet gentemot Microsoft i EU med den höga bevisbördan på Microsoft och faktumet att förhållningssättet är i linje med etablerat praxis reflekterar den fortsatt misstänksamma attityden mot kopplingsförbehåll.

USA:s appellationsdomstol, distriktsdomstolen av Columbia, visar emellertid på en förändring i attityden mot kopplingsförbehåll med fallet Microsoft och dess kopplingsförbehåll av Internet Explorer med Windows. Ett fullt bindande svar kan emellertid inte dras från rättsfallet eftersom det inte har beslutats av Högsta Domstolen. Tills det sker så tillämpas en per se regel mot kopplingsförbehåll.

Vad gäller frågan om en lämplig åtgärd, en åtgärd som inte är hämmande mot fortsatt nyskapande, så finns det inget generell rätt svar utan utvärderingen måste ske från fall till fall.

En kan säga att vi rör oss i rätt riktning där det är en klar gräns mellan konkurrensfrämjande och konkurrensbegränsande kopplingsförbehåll och där kopplingsförbehåll är sedd med positiva ögon. Med andra ord, ett rule of reason snarare än ett per se rule förhållningssätt gentemot kopplingsförbehåll. Konkurrensrätten måste lära sig att klara sig med en ny sorts ekonomi där kopplingsförbehåll är ett vanligt inslag.

Preface

Present thesis mark the end of five and half years of law studies. It has been a long journey. Along on this journey, I have had the pleasure to have four close friends accompanying me and I want to direct special thanks to them, namely Anders Mrdja, Carl Henrik Gunnehill, Christian Larenas and Martin Johansson.

I want to take the opportunity and thank my supervisor Professor Hans Henrik Lidgard.

In addition, the people, who set aside valuable time to proofread my thesis, are worth a big thank you.

I want also to thank my wife, Nergjivane, and my family for their support.

This thesis is dedicated my father, Naim Brahimi, for his support and guidance.

Malmö 2008-12-01

Abbreviations

API	Application Programming Interface
CFI	Court of First Instance
DG	Directorate-General
DOJ	Department of Justice of the United States of America
DRM	Digital Right Management
EC	European Community
ECJ	European Court of Justice
ECLR	European Competition Law Review
EU	European Union
FTC	Federal Trade Commission
IAP	Internet Access Provider
IE	Internet Explorer
IEAK	Internet Explorer Access Kit
ICP	Internet Content Provider
ILC	International Review of Industrial Property and Copyright
IP	Intellectual Property
IPR	Intellectual Property Right
ISV	Independent Software Vendor
IT	Information Technology
JVM	Java Virtual Machine
NCA	National Competition Authority
OEM	Original Equipment Manufacturers
OS	Operating system/s
PC	Personal Computer
R&D	Research and Development
SMEs	Small and Medium Enterprises
U.S.	United States (of America)
WMP	Windows Media Player

1 Introduction

Intellectual Property (IP) is a legal field that refers to the creations of the mind. There are a significant number of Intellectual Property Rights (IPRs), with each one tailored to protect a particular example of IP.[1]

The attitude towards IPRs is different than it has been in the past. IP is a key driver in the EU economy, and sound competition policy will work to maintain a robust marketplace so that new products and services can flourish. Today's industries – information, technology, telecommunications and biotechnology – are dependent on IPR protection for investment. The development of these industries is crucial to growth and competitiveness in global trade.[2]

Competition authorities on both sides of the Atlantic acknowledge the fact that IPRs and competition law share the same basic objective of promoting consumer welfare and providing an efficient allocation of resources. Nevertheless, potential conflicts arise between IPR and competition law owing to the means used by each system to promote these goals. In this respect, IPRs have often given rise to competition-related concerns being raised by competition authorities around the world.[3]

The central element of an IPR is to give the owner of the right an exclusive right to use his/ her work; importantly, it also grants the owner a right to exclude others from unauthorised use of the work. IPR rights are limited by space and time. Competition law, on the other hand, seeks to avoid market barriers and to benefit consumers by encouraging competition among a multiplicity of suppliers of goods, services, and technologies.[4] For example, innovation is a competition driver and rewarded through the granting of IPRs. However, when the actor owns a monopoly or enjoys a dominant position, innovation may generate anti-competitive effects by turning the IPRs into an exclusionary practice.[5] This conflict is evident in the notorious *Microsoft* case, touching on these domains, involving both the U.S. and the EU.

One of the issues brought up by the case is that of tying and bundling, i.e. software integration. The European *Microsoft* case concerned tying and bundling of Microsoft Windows Media Player (WMP) with the Windows client Personal Computer (PC) Operating System (OS), while the U.S. *Microsoft* case concerned tying and bundling of Microsoft's Internet Explorer (IE) web browser software with its Microsoft Windows OS.

Tying and bundling cases raise very complex issues involving IP and competition. One of the issues at stake is the question of when anti-competitive effects are likely to arise from tying and bundling. The second issue is what actions to take against anti-competitive tying and bundling.

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[1] Phillips, Jeremy & Firth, Alison: page 4.
[2] Lidgard, Hans Henrik & Atik, Jeffery (ed.): page 184. Anderman, Steven D.: page 6-7.
[3] Jones, Alison & Sufrin, Brenda: page 803-804.
[4] Phillips, Jeremy & Firth, Alison: page 6-8.
[5] Montagnani, Maria Lillá: page 623.

These difficulties are particularly acute in the area of technological tying which frequently arises in the IT and software sector.

The phenomenon of tying and bundling is widely used throughout our economy. Tying and bundling is not tied exclusively to matters concerning anti-competitive effects, but may also be pointed out as encouraging a number of pro-competitive effects. Consequently, it is important to strike a balance between competition law and IPRs. Overprotection might interfere with healthy competition and, consequently, the consumer would not benefit from it. On the other hand, too much protection for IPRs might give the innovator the possibility of suppressing a significant technological development. Henceforth, the societal interest that might have benefited from this diminishes.[6]

1.1 Purpose

The purpose of this thesis is to examine when tying and bundling goes from having pro-competitive effects to having anti-competitive effects, and what are the proper remedies against anti-competitive effects?

1.2 Delimitation

The thesis has been limited in several aspects in order to maintain a sharp focus on the key issues.

The thesis is predominantly going to analyse the abusive practice of tying and bundling portrayed in the *Microsoft* case and regulated in Art. 82 EC. However, interesting parallels will be drawn, first with regard to other case law and provisions regulating tying and bundling, such as Art. 81 EC and second, with regard to the U.S. *Microsoft* case.

1.3 Method

The thesis uses a form of the traditional legal dogmatic method and to a lesser extent the comparative legal method.

There is no consensus as to what a traditional legal dogmatic method entails. However, one view is that it is used to interpret applicable law as well as systematically present applicable law. Materials, such as existing legislation, preparatory work, case law and doctrine, describe the state of the law under the traditional legal dogmatic method. The material are valued and analysed in relation to the legal issue to be analysed, and the material used are meant as the tool for bringing clarity. In our case, the issue of tying and bundling and its pro-competitive or anti-competitive effects, along with the question of proper remedy against anti-competitive tying and bundling. The Americans describe the traditional legal dogmatic method as the “law in books”.

Due to the nature of EU law and U.S. law, the analysis and the interpretation of their provisions is different from the traditional legal

[6] MacQueen, Hector & Waelde, Charlotte & Laurie, Graeme: page 8 and onwards.

dogmatic method used in Swedish law. A traditional legal dogmatic method applied in Swedish law uses a systematic analysis of relevant legislation/ provisions, preparatory work, case law, and doctrine. In EU law and U.S. law, preparatory work has largely no legal significance, while case law is of fundamental importance when interpreting legislation/ provisions. Consequently, case law comes high in the hierarchy of legal sources and is of great importance in this thesis. Furthermore, even doctrine is of more relevance than in Swedish law.

This thesis will also compare and contrast the EU *Microsoft* case with the U.S. *Microsoft* case.

A comparative legal method entails the comparison of two legal orders, a method to analyse and ascertain the similarities and differences between the two legal orders. The comparative legal method should, however, be thoroughly explained and thought before it is used, since many traps lie ahead and it is easy to fall into one. Why would one then make a comparative journey?[7]

A comparative study inevitably leads to the finding of similarities and differences. Importantly, one gets a better picture of how another jurisdiction deals with certain legal issues, such as tying and bundling and of whether that solution could be proven better for society. This is a meaningful comparison, because it is one between objects that share common characteristics, i.e. rules that address the similar situations. The EU and U.S. *Microsoft* decisions deal with tying and bundling and the manner that the two jurisdictions tackle these issues will be analysed in depth.

By examining the *Microsoft* cases, one can get a better understanding of the state of the law on tying and bundling. Moreover, it provides us with the possibility of insight to the best approach towards tying and bundling.

1.4 Material

In the EU, the material concerning primary law has been predominantly Art. 82 EC. The case law on tying and bundling is scarce, especially concerning cases involving technical integration as was employed by Microsoft. Hence, secondary sources, being articles and publications by various legal scholars and practitioners will also be discussed. Moreover, the *Microsoft* cases will receive significant attention.

The authors of the various materials are reputable legal scholars that provide a balanced view on the issue of tying and bundling and the *Microsoft* case. As part of the materials used is the Course book in European Competition Law compiled by Prof. Dr. Wouter Devroe. He is law professor at the Department for Economic Law, Katholieke Universiteit Leuven.

My intention is that this thesis will provide a good objective foundation for further discussion, such as a PhD, on the issue of tying and bundling. It is an important subject to be discussed, especially as regards the

[7] For further reading on the Comparative legal method, I recommend Bogdan, Michael, *Komparativ Rättskunskap*, second edition, Norstedts Juridik AB, 2003.

issue of technological tying and bundling in the technologically driven society of today.

1.5 Disposition

The subsequent chapter of this thesis presents an overview of tying and bundling and its pro-competitive and anti-competitive effects. The purpose is two-fold. First, a definition of tying and bundling in order to understand what the thesis is about. Second, it intends to show the reason why the practice of tying and bundling is a focal point of this thesis. The intention is to bring up the positive effect, the pro-competitive features, of tying and bundling and to examine its importance in society. On the other hand, a negative aspect to the practice of tying and bundling is the anti-competitive effects of tying and bundling.

Chapter three discusses the EC legislation on tying and bundling. A detailed analysis of the legislation is not intended. Rather, the focus will be on the specific provision/ paragraph regulating tying and bundling, namely Art. 82 (d) EC. It will deal with the structure of that provision and the criteria for it to be applicable. Moreover, the European Commission Directorate-General (DG) Competition Discussion Paper on Art. 82 EC will be addressed in order to come to an understanding of the European Commission's view on tying and bundling. Before concluding, a brief look at Art. 81 EC will occur to see what interesting parallels exist between these two provisions concerning tying and bundling.

The focus of chapter four will be on the EU *Microsoft* decision. As previously, mentioned, case law is of fundamental importance when interpreting legislation/ provisions. This chapter will discuss the effect of the remedy chosen and applied against Microsoft in their practice of tying and bundling. Chapter five address the U.S. *Microsoft* decision in a similar fashion to the discussion in Chapter four. Chapter six will provide a comparison of the two *Microsoft* cases. By looking at both the *Microsoft* cases in the EU and at that in the U.S. differences and similarities between the two legal jurisdictions will be revealed and analysed. The chapter will examine how these two legal jurisdictions have chosen to deal with the issue of tying and bundling and what lessons can be drawn.

The final chapter analyses tying and bundling and the *Microsoft* cases. It will look at the effects of and some of the criticism levelled at the cases. Significantly, this chapter will provide solutions to complicated issues dealing with these issues.

2 The Practice of Tying and Bundling

2.1 Defining Tying and Bundling

Various types of tying and bundling exist and the central question depends on how many components of a bundle/ tie are individually sold. However, there are three general practices of tying and bundling, namely tying, bundling and mixed bundling. These practices can be used in combination with each other or individually and may have similar effects on competition.

Tying is a practice where the sale of one product, i.e. the tying product, is conditional on the purchase by the customer of a second product, i.e. the tied product. The seller refuses to sell one product unless the buyer also takes another product. For example, product A, i.e. the tying product must be purchased with product B, i.e. the tied product. The tied product, however, can also be purchased separately. Henceforth, only AB and B are sold in the market.[8]

Tying may take various forms, such as;[9]

Contractual, i.e. customers cannot purchase the second product separately.

Refusal to supply, i.e. a dominant undertaking refuses to supply the tying product unless the customer purchases the tied product.

Withdrawal or withholding of a guarantee, i.e. the dominant supplier withdraws or withholds the benefit of a guarantee unless a customer uses the supplier's components as opposed to those of a third party.

Financial, i.e. the price for two products is lower then the price for separate products. Customers are coerced into buying the products as a package.

Technical, i.e. where two separate products is integrated technically as one, so it is impossible to take one product without the other.

The practice of bundling is very similar to the idea of tying and refers to two types of bundling, pure bundling and mixed bundling. Pure bundling is where the seller provides the two products as a package, selling them in fixed proportions, i.e. a take-it-or-leave-it proposition, with no option to buy A or B separately. Consequently, a contractual obligation exist when the structure of the product offering rather than as an obligation on the customer to purchase the tied product. For example, product A and B can only be purchased as a bundle, i.e. none of the package components are offered

[8] O'Donoghue, Robert & Padilla, A Jorge: page 101, 477. DG Competition discussion paper: page 54.
[9] Whish, Richard: page 679-680. Jones, Alison & Sufrin, Brenda: page 515.

individually but only as AB. Pure bundling may be achieved also through technological links.[10]

Mixed bundling, which is a weaker form, arise when products A and B are sold in a bundle but are also available separately. The bundled offer is made available at a discount compared to the sum of the price of the components, i.e. the bundle, AB, is cheaper than the individual products, A and B, together. Nevertheless, it would still be possible to, instead of purchasing products A and B as a bundle, i.e. AB together, do so also individually, i.e. A and B, but at a greater cost.[11]

As regards the effect of tying and bundling practices on the market, there are two sides. One side proclaims the pro-competitive effects of tying and bundling as a practice while the other side proclaims its anti-competitive effects. A conclusive answer to the issue of the practice of tying and bundling and its pro-competitive effects or its anti-competitive effects depends on the type of bundling at issue and the position of the company practicing tying and bundling in that market.

2.2 Pro-competitive Effects

The practice of tying and bundling is a common feature in our economy and part of our daily life. For example, a car comes assembled with all its components and not with separate components; earrings sold in pairs; software packages are integrated into operating platform software. The underlying reason behind this is that tying and bundling generates pro-competitive effects for consumers from an efficiency standpoint, such as lowering production, information, and transaction costs, as well as increased convenience and variety. Furthermore, there is an expectation and demand from the consumers for software packages integrated into the operating platform software.[12]

In most cases, products and services are placed into components or parts, however, in such a case, enormous costs would be imposed on sellers and consumers who would end up paying higher prices for products.[13]

Further, tying and bundling may in turn, among other things, create economies of scale and scope in production and distribution due to efficiencies gained. Tying and bundling reduce the costs of searching for the most appropriate combination of products that satisfy a complex need and give rise to new or improved products and services and help manufacturers ensure quality.[14]

Economies of scale and scope in production and distribution exist, for example, when machines manufacture two or more products. This allows the producer to reduce the size or complexity of his/ her factories, which might lead to lower production costs and in turn lower prices for consumers. Furthermore, marketing and distribution costs may reduce when companies combine various products or services. This demonstrates that the cost of

[10] Anderman, Steven D. & Kallaugher, John: page 279. Ridyard, Derek: page 316.
[11] O'Donoghue, Robert & Padilla, A Jorge: page 101.
[12] Evans, David S. & Padilla, A. Jorge & Polo, Michele: page 509, 511.
[13] Hovenkamp, Herbert: page 399.
[14] Whish, Richard: page 680-681.

producing an additional pill that contains both headache and pain reliever medicine is lower than to produce two.[15]

In the past, it was more common for consumers to buy individual components and assemble them themselves. Yet, currently companies bring skill, knowledge, experience, and other resources to tying or product integration. Allowing consumers to assemble the individual components themselves may affect the quality of the final product, to the detriment of both producers and consumers. Increasing technological sophistication makes it more difficult to ensure that the final product will meet consumer satisfaction, as well as raising the question as to whether the fault regarding any malfunctions can be traced to the consumer or to the supplier of the components. Equipment manufacturers may end up with an undeserved reputation for poor quality. Henceforth, bundling components together gives both the consumer and the producer greater certainty regarding product quality.[16]

Not all consumers are lost in the technological jungle, and some do feel comfortable with technological sophistication and with the task of assembling a product themselves. A choice should exist for those who feel that they can assemble technological products, as well as for the others who do not feel as self-confident with the task of assembling technological components into a product. Moreover, from a basic economic rational, tying and bundling are about the savings that result from the joint manufacturing and joint distribution of products and services. Usually, the products would be significantly more costly, if consumers were not able to buy it in a bundle. However, in those markets of tying and bundling there might be companies willing to offer that choice if they feel that there is a demand among consumers. What is important in this situation is that companies involved in tying and bundling must not in any way try to distort the competition and drive out companies wanting to sell separate components.[17]

Consumers benefit from software integration since it promotes development of new software products through taking advantage of existing integrated systems. Software developers that already know the properties of an application through its being bundled into an OS can design new applications that fit into an existing framework, which ultimately results in variety.[18] A comparable example given by certain authors is that it is more efficient to sell cars with the tires on than to sell them without tires; thus, having consumers buy and install the tires separately is undesirable.[19]

2.3 Anti-competitive Effects

The anti-competitive side of tying and bundling refers to foreclosure, price discrimination, and high prices.[20]

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[15] Bishop, Simon & Walker, Mike: page 213.
[16] Evans, David S. & Padilla, A. Jorge & Polo, Michele: page 509, 510.
[17] O'Donoghue, Robert & Padilla, A Jorge: page 483.
[18] Evans, David S. & Padilla, A. Jorge & Polo, Michele: page 510.
[19] Elhauge, Einer & Geradin, Damien: page 504, 505.
[20] DG Competition discussion paper: page 54.

According to economists, a company enjoying monopoly power in the tying product market might have an anti-competitive incentive to tie, when the tied product market is imperfectly competitive. This can lead to a foreclosure of the market indirectly. The tying keeps potential rivals out of the market for the tied product or helps the monopolist to preserve its market power in the tying product. By tying, the dominant company reduces the number of potential consumers that is available for its competitors in the tied market. Henceforth, their profits may diminish below the level that would justify remaining active in that market or, alternatively, those who want to enter that market. Economies of scale, network effects, and high entry barriers in the tied market all make such a strategy more likely and more successful.[21]

The foreclosure of the tied market may allow the dominant company to achieve larger profits in the tied market, for example through catching more of the customers in that market. In addition, the dominant company may protect or strengthen its dominant position in the tying market by tying. A dominant firm in the manufacturing industry making its product available to consumers only through its own retail outlets might prevent the emergence of an independent retail sector, a retail sector that in the end could be a new rival for the dominant firm's position in manufacturing. A new rival would have to enter both the tying and the tied market in order to compete effectively, which would require a substantial amount of effort and could be a disincentive for a new rival.[22]

A business with monopoly in one market may be able to leverage its monopoly into another market and raise prices above the competitive level in the second market. For example, computer game consoles require games, and if a monopolist on the market for computer game consoles would tie the sales of games, this could be used effectively to charge more to those consumers who are users of the monopoly product. This theory has, though, been criticised and some argue that it is not possible for a firm to leverage monopoly power from one market to a secondary market.[23]

The software market is one example of a high-tech market with specific features. In this market, software integration may be capable of hampering competition in an aftermarket such as the browser market, if adopted by a firm leading an upstream market. The argument of the software market operators is that they benefit from their innovation because of the granting of IPRs and that their behaviour falls within the boundaries of their exclusive right granted by an IPR.[24]

Network effects are a characteristic feature of the new economy industries. The products of the new industries are more valuable to each user if more people use them. Network effects may have important implications

[21] O'Donoghue, Robert & Padilla, A Jorge: page 484. Evans, David S. & Padilla, A. Jorge & Polo, Michele: page 511. Whish, Richard: page 681.
[22] Ridyard, Derek: page 317. Whish, Richard: page 681. Bishop, Simon & Walker, Mike: page 210, 215-216.
[23] Bishop, Simon & Walker, Mike: page 210-211. Van den Bergh, Roger J. & Camesasca, Peter D.: page 265-266.
[24] Montagnani, Maria Lillá: page 623.

on market structure and on firms' conduct. A monopoly or an oligopoly will be the norm and the competitive prices will depend on network size.[25]

Intervention is justified even in industries with high quality products, low prices and a high rate of innovation, with regard to foreclosure of firms that would like to enter the market, whether or not their possible entry would benefit consumers. In other words, competition law puts more emphasis on competitors than on the welfare of consumers.[26]

2.4 Conclusion

A consensus does not exist involving the practice of tying and bundling with regard to whether it is a practice having pro-competitive effects or anti-competitive effects. Moreover, there does not seem to be a possibility of clear-cut line being drawn between these two possible scenarios.

Tying and bundling is a concept that needs to be clarified, with necessary distinctions being made where applicable, because it refers to different practices. In the practice of tying, the products are two distinct separate products that, when sold, place the condition on the buyer to take both of them on the purchase of one of them. Bundling, on the other hand, refers more to a contractual obligation created by the structure of the product offerings, i.e. the seller provides the two products as a package, a bundle. In other words, the practice of bundling is very similar to the idea of tying. However, one can argue, if instead there should be a made a distinction between tying and bundling based on its effect. In my view, bundling can be seen as a form with more pro-competitive effects then anti-competitive effects. Tying on the other hand can be seen as more anti-competitive.

With regard to the question of pro-competitive effects and anti-competitive effects, economists do not seem to be able to reach a consensus on the matter. What is for certain, however, is that tying and bundling is a common practice. The practice of tying and bundling has penetrated the economy and if they were not generally beneficial, such practices could not survive in competitive markets. This statement alone should lend support to the argument for tying and bundling being considered pro-competitive.

Nevertheless, there are two camps, one proclaiming tying and bundling as a practice of pro-competitive effects and the other one proclaiming tying and bundling as a practice of anti-competitive effects. Both sides provide models and theories for one or the other side. These models and theories are not waterproof, because they rely on highly specific market structures, and the results are very sensitive to changes in the underlying assumptions.[27]

With regard to the anti-competitive theories, they rely on the company having a dominant position. However, if there is neither a tying market

[25] Ahlborn, Christian & Evans, David S. & Padilla, A. Jorge: page 158-159.
[26] Ibid. page 165-166.
[27] Van den Bergh, Roger J. & Camesasca, Peter D.: page 266.

power nor substantial tied market foreclosure, then none of the anti-competitive theories can apply.[28]

Generally, the pro-competitive effects theories do not have any real empirical evidence to support them. One exception is Evans and Salinger[29] investigation of three types of products, decongestants/ pain relievers, foreign electrical adapters, and optional equipment for automobiles; they concluded that tying and bundling has pro-competitive effects with regard to costs in this situation.

Most economists would agree in fundamental claims regarding tying and bundling. The first one is that tying is a pervasive practice that, in many instances, gives rise to substantial efficiencies. Both economies of scale and marginal cost savings usually play an important role in a firm's decision to provide a bundle instead of individual components. Secondly, the circumstances in which tying would lead to anti-competitive effects can be said to be restricted and hard to verify.[30]

Nevertheless, the practice of tying and bundling is regulated in Art. 82 EC because it is considered to have the effect of distorting competition if undertaken by a dominant undertaking.

[28] Elhauge, Einer & Geradin, Damien: page 498, 504.
[29] Evans, DS & Salinger, M.: *Why do firms bundle and tie? Evidence from Competitive Markets and Implications for Tying law*, 2005, 22 Yale Journal on Regulation 37-89.
[30] O'Donoghue, Robert & Padilla, A Jorge: page 491

3 EC Competition Law on Tying and Bundling

Art. 81 and Art. 82 EC are applicable to the practice of tying and bundling. However, Art. 82 EC is usually determinative in most cases. These two provisions differ from each other and, even if the central focus will not be on Art. 81 EC some interesting parallels will be drawn later on in this chapter with regard to the practice of tying and bundling.

3.1 Art. 82 EC

In this chapter we consider when tying and bundling constitute an abuse of a dominant position. The general prohibition in Art. 82 EC establish the framework for the rule regulating undertakings in a dominant position. Four elements must be established before the prohibition of Art. 82 EC occurs.

First, one or more undertakings must be involved. With regard to the first condition, *ratione personae*, parties being one or more undertakings, it includes unilateral behaviour or behaviour from several undertakings. The concept of an undertaking encompasses every entity engaged in an economic activity regardless of its legal status and financial structure. This rule generally has wide applicability.[31]

Second, the undertaking or undertakings in question must hold a dominant position within the common market or a substantial part of it. The notion of dominance has developed through case law. It relates to a position of economic strength, which enables an undertaking or undertakings to hinder the maintenance of effective competition on the relevant market by giving it the power to behave to an appreciable extent independently from its competitors and consumers.[32]

To determine whether dominance exist the answer to these two questions are necessary; what is the relevant market and what is a player's market power? The relevant market issue is of great importance and will often determine the entire outcome. The larger the relevant market is, the less the chances of there being dominant position are. Further, when a dominant position does not exist, there can be no abuse of dominant position. When determining the relevant market, one has to look into three variables: the relevant product market, the relevant geographic market, and the temporal factor. The main purpose of defining the market is to identify in a systematic way the immediate competitive constraints faced by an undertaking. With regard to defining the market in its product and geographic dimensions, the purpose is to identify all actual competitors on the market, and thus be able to point out which of those are the undertakings that are capable of constraining its behaviour.[33]

[31] W. Devroe: page 66.
[32] Ibid. page 68.
[33] DG Competition discussion paper: page 6.

Third, the behaviour of the undertaking must be abusive. The element of abuse does not need a connection to the dominant position. It is necessary that the conduct strengthens the undertaking's dominant position and fetters competition on the market.[34]

Fourth, it must have an effect on inter-state trade, because if it does not have intra-state effect then it is a matter for the national courts and not the Community courts to address the issue.[35]

When an undertaking is in breach of Art. 82 EC various penalties may be established including fines, claims for damages, the imposition of remedies such as a duty to deal or to raise lower prices, and the ordering of structural changes in the dominant undertaking. These sanctions must be reasonable in scope and administrable in practice.[36]

3.1.1 DG Competition Discussion Paper on the application of Article 82 of the Treaty to exclusionary abuses

Art. 82 EC is a complex provision, with the analysis of dominance and abusive behaviour under it entailing complex economic considerations. As a result, the European Commission has had Art. 82 EC subject to revision. The product of this was the Discussion Paper[37] on exclusionary abuses, which gives important indications as to how the Commission approach exclusionary abuses, among those tying and bundling.

3.1.2 The Element of Abuse

According to the European Court of Justice (ECJ), abuse is an objective concept relating to the behaviour of an undertaking in a dominant position. Such behaviour would aim at influencing the structure of a market, or a decrease in competition or lack of growth of competition would arise because of the very presence of the undertaking. Moreover, the methods employed by such undertaking would be different from the conditions present in normal competition.[38]

Art. 82 EC includes a non-exhaustive list of different abusive modes of conducts. Broadly, three types of abuses under Art. 82 EC can be distinguished: exploitative abuses, exclusionary abuses and reprisal abuses. Tying and bundling falls under the category of exclusionary abuses, namely strategic acts aimed at rivals causing the loss of consumer welfare by unlawfully limiting rivals' ability to compete. When analysing exclusionary conduct, the protection of competition on the market as a means of

[34] Jones, Alison & Sufrin, Brenda: page 322.
[35] Anderman, Steven D.: page 40.
[36] Whish, Richard: page 189.
[37] DG Competition discussion paper on the application of Article 82 of the Treaty to exclusionary abuses, December 2003.
[38] Van den Bergh, Roger J. & Camesasca, Peter D.: page 248. See also C-85/76 *Hoffmann-La Roche v Commission*.

enhancing consumer welfare and of ensuring an efficient allocation of resources is the essential objective.[39]

An obvious danger with the element of abuse is that it might be too broad because it may apply to practices that have only limited anti-competitive effects, if any at all. Hence, competition law may act as a deterrent to competition. An underlying reason for this is that the EC Treaty uses broad and non-specific language and it is up to the EU institutions, the European Commission and the European Courts, to decipher the treaty.[40]

3.1.2.1 Art. 82 (d) EC and the Five Element

Tying is mentioned by Art. 82 (d) EC as a possible form of abuse, specifying it to be the making of the conclusion of contracts subject to acceptance by other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.

The policy of the European Commission regarding tying and bundling has not been constrained by the precise wording of Art. 82 (d) EC, and limited to the textbook example of coercing consumers of a dominant tying product into buying the tied product by contractual agreement. Instead, it has been identified in a variety of business practices. Tying and bundling is the possible abuse of the practice by which a dominant company either imposes on consumers the acquisition of one product or service conditional upon the purchase of another, i.e. tying, or forces or economically induces customers to buy only a bundle consisting of the two products, i.e. pure or mixed bundling. Tying and bundling abuse may arise even when a link exists, by nature or normal commercial usage, between the products. Despite, the different underlying effects on competition and efficiency considerations contractual tying and technological tying are assessed in the same manner.[41]

The essential objective of Art. 82 EC when analysing exclusionary conducts is the protection of competition on the market as a means of enhancing consumer welfare and of ensuring an efficient allocation of resources. An important aspect in this is the prevention of exclusionary conduct of the dominant firm likely to limit the remaining competitive constraints on the dominant company, including entry of newcomers, to avoid that consumers are harmed. Henceforth, competition and not competitors are to be protected. However, genuine competition based on higher quality, novel products, opportune innovation or better performance should not be distorted.[42]

For tying and bundling practices to be prohibited under Art. 82 EC, five criteria need to be fulfilled: (i) the company concerned is dominant in the tying market; (ii) the tying and tied goods are two distinct products; (iii) coercion, i.e. conduct forcing customers to buy the tied product together with the tying product; (iv) the tying practice is likely to have a market-

[39] O'Donoghue, Robert & Padilla, A Jorge: page 174-175.
[40] Whish, Richard: page 189, 191.
[41] O'Donoghue, Robert & Padilla, A Jorge: page 491. DG Competition discussion paper: page 55.
[42] DG Competition discussion paper: page 17-18.

distorting foreclosure effect; (v) the tying practice is not justified objectively or by efficiencies.[43]

Dominance[44]

Dominance is a precondition for any finding of abuse under Art. 82 EC, in the absence of which the said article will not be applicable. Thus, the first requirement in the case of an alleged tying abuse is to establish that the firm has a dominant position in the market for the tying product. An analysis of dominance is dependent upon prior findings in the relevant markets in which both the tying and the tied product are sold.[45]

To have a dominant position is not an offence under Art. 82 EC, but to abuse it is. A dominant undertaking has a special responsibility not to allow its conduct to impair undistorted competition on the common market.[46] If the undertaking is dominant in the market for the tying product, it may render the practice of tying more likely to be liable of distorting competition for the tied product. Customers dependent on the tying product must acquire the tied product irrespective of its merits. This may cause a risk of excluding competition. On the other hand, if there is effective competition in the market of the tying product, customers has alternatives to the tied product and no competitive concerns should arise.[47]

Among non-dominant companies, without market power, tying is a common practice and the competition among these companies ensures that only ties generating real benefits for consumers will succeed in the market.[48]

Separate product[49]

The second requirement is establishing whether products A and B are separate products. The main criterion to analyse in establishing whether two products are separate or integrated is the potential user or consumer demand for the tied product individually, from a different source than for the tying product. If B is a separate product, the relevant question is whether there is demand for A as a stand-alone product. Are there consumers prepared to pay a price to acquire product A without product B attached? If so, then A and B are separate products, otherwise, there are two products AB and B, and A is just a component of the first of the two products. When there is no demand for acquiring the components separately from different sellers, then no competition-related issues under Art. 82 EC arises. Tying can only occur when the products are genuinely distinct.[50]

However, it is not necessary that the two products belong to two separate product markets. The separate product test is merely a rule of

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[43] DG Competition discussion paper: page 55. See also Case *Hilti AG v. Commission*. Case *Tetra Pak International SA v. Commission*.
[44] DG Competition discussion paper: page 55-56.
[45] Dolmans, Maurits & Graf, Thomas: page 226. Anderman, Steven D.: page 74.
[46] Whish, Richard: page 183-184.
[47] Dolmans, Maurits & Graf, Thomas: page 226.
[48] Ibid. page 226.
[49] Whish, Richard: page 682-683. DG Competition discussion paper: page 56.
[50] Anderman, Steven D. page 73. Dolmans, Maurits & Graf, Thomas: page 227.

thumb test, to be used in answering the question of whether the tie is efficient from the customer's perspective.[51]

A strong indicator for the existence of demand is the presence of suppliers that offer the tied product separately, or the company's own commercial conduct, i.e. the company promotes and advertises the tied product as a distinct product or it applies different commercial conditions for the tying and the tied products. Moreover, one can also examine whether acquiring a collection of individual components from various sources constitutes a substitute for the tied bundle. In the case of cars or a mobile phone with a camera, the producer provides a genuine integration service, generating value to consumers and differentiating the integrated product from its individual components. This implies that if there is an inherent link or customary link between the products, then there will be no abuse. However, Art. 82 (d) EC specifically prohibits supplementary obligations, which by their nature or according to commercial usage have no connection with the subject of such contracts.[52]

Yet, the separate product test has been criticised. The argument put forward in this regard is that the test does not function because consumers' market perception changes over time. Separate demand for two products might fade if bundling creates genuine benefits. It is equally possible that demand for separate components will remain stable if there are benefits in the separate components. For example, car radios are still available separately because there are quality differences in them, and it is not that burdensome to offer them separately. It is important that the choice to buy separately is present and that anti-competitive behaviour does not distort the market.[53]

Coercion

Coercion is a key element of a tying claim, without coercion a tie could not have an impact on competition. Coercion arises if the dominant company denies customers the realistic choice of buying the tying product without the tied product. It may be contractual, financial through prohibitive discounts or by removing certain benefits, or through technical bundling practices.[54]

A contractual coercion occurs when the requirement to buy product B is a condition for the sale of product A, i.e. a refusal to supply the tying product separately. Technical coercion is preventing the user from using the dominant product without the tied product. Financial coercion, on the other hand, is a package discount making it meaningless to buy the tied product separately.[55]

An important factor regarding coercion is that reduction of discount and other discriminatory policies are illegal because they do not leave the customer a choice to buy the products separately.[56]

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[51] Dolmans, Maurits & Graf, Thomas: page 227, 230. Jones, Alison & Sufrin, Brenda: page 516.
[52] Dolmans, Maurits & Graf, Thomas: page 227-228.
[53] Jones, Alison & Sufrin, Brenda: page 517. Dolmans, Maurits & Graf, Thomas: page 228. Whish, Richard: page 683.
[54] Anderman, Steven D.: page 74. Jones, Alison & Sufrin, Brenda: page 517-518.
[55] Dolmans, Maurits & Graf, Thomas: page 230.
[56] Dolmans, Maurits & Graf, Thomas: page 231.

Distortion of competition[57]

Factual evidence of foreclosure is not necessary as a constituent element of tying under Art. 82 EC, but it is enough to show that tying may have a possible foreclosure effect on the market.[58]

An assessment of the risk of foreclosure shall use substantiated evidence to determine whether a negative impact on competition occurs. Various factors can be substantiating evidence, such as comparing shares of sales development before and after the tie, effects of previous tying practices by the same company in neighbouring markets, the degree of market power exercised by the dominant company, the customer's dependence on the tying product or the characteristics of the market for the tied product.[59]

Tying by a dominant company may distort competition if the company relies on the dominance in its tying product to promote sales of the tied product, instead of competing on the merits in the tied market. Competition in the market for the tied product will be foreclosed because customers for the tied product that also need the tying product will be driven away from third party suppliers. This is often troublesome especially if the market opportunity for the tied product without the dominant product is limited or insufficient to allow a minimum efficient scale of operation for competitors. The more users of the tied product are dependent on the dominant product, the more impact the tying will have.[60]

Objective and proportionate justification[61]

The practice of tying and bundling can be justified on a legitimate and proportionate basis. If the European Commission manages to prove the existence of the first four requirements, the burden of proof for objective justification for the practice of tying and bundling shifts to the defendant.[62]

Legitimate objectives put forward for practising tying and bundling must be genuine and substantiated by providing specific evidence for the claim. A legitimate objective is when tying and bundling enhances efficiency because it is more costly to produce, or distribute the tied products separately, or there might be a need to ensure the quality or safety of the products. Compulsory usage or other links between products is not a sufficient defence and can be a tying abuse. If there is demand to acquire the tied product from a different source than the tying product, then the dominant company is under an obligation not to act as to hinder this. It does not matter that the products constitute complements or connected by natural links or commercial usage. However, if tying and bundling saves customers substantial costs, i.e. more than the value they derive from competition in the tied product, demand for the tied product to separate diminishes. When

[57] DG Competition discussion paper, page 56-60.
[58] Dolmans, Maurits & Graf, Thomas: page 233-234.
[59] Ibid. page 234.
[60] Ibid. page 232.
[61] DG Competition discussion paper, page 60.
[62] Anderman, Steven D.: page 76.

this occurs, the components are a single product and the tie should be allowed in such cases.[63]

A genuine and substantiated justification for the tying practice must outweigh the anti-competitive effects of that practice by subjecting the practice to a proportionality test. There are three elements to the proportionality test: first, tying and bundling must effectively allow the firm to achieve the claimed benefits: second, the practice of tying and bundling has to be necessary to achieve the claimed benefits: third, it is impossible to achieve the benefits by any less restrictive means.[64]

However, one has to keep in mind that a dominant company is entitled to protect its commercial interests. Nevertheless, the company has a special responsibility, and the real purpose for the behaviour must not be to strengthen its dominant position.

3.1.3 Bundling

Bundling can achieve the same effects as tie-in agreements through pricing practices. For example, a firm may sell two or more products together as a bundle and charge more attractive prices for the bundle than for the constituent parts of it. In *Digital,*[65] the European Commission objected to the practice by which Digital offered prices that were more attractive when customers bought software services in a package with hardware services than when purchasing software services on a stand-alone basis. Consequently, it was uneconomical to buy the hardware from a third party, with the result of companies in the hardware maintenance market excluded from servicing Digital systems.[66]

In *De Post-La Poste*[67], the Belgian Post office offered lower prices to customers in the market for the delivery of letters if they also made use of a separate business-to-business service that it provided.[68]

Other pricing practices are rebates having a tying effect, which occurred in the cases of *Eurofix-Bauco v Hilti, Tetra Pak II*, and *PO-Michelin.* In *Eurofix-Bauco v Hilti*[69], the defendants reduced discounts to customers for orders of nail cartridges without nails, and this was considered by the ECJ as abuse of a dominant position. In *Tetra Pak II*[70], however, the company had adopted a pricing policy as means of persuading customers to use its maintenance services. *PO-Michelin*[71], involved a bonus scheme that enabled Michelin to leverage its position on the market in new

[63] Dolmans, Maurits & Graf, Thomas: page 229, 230, 235.
[64] Ibid. page 236.
[65] Commission's XXVIIth Report on Competition Policy, 1997, page 130-131.
[66] Jones, Alison & Sufrin, Brenda: page 521.
[67] Commission Decision of 05.12.2001 relating to a proceeding under Article 82 of the EC Treaty (COMP/37.859 – De Post-La Poste).
[68] Whish, Richard: page 728-729.
[69] Commission Decision of 22.12.1987 relating to a proceeding under Article 86 of the EEC Treaty (Case IV/30.787 and 31.488 – Eurofix-Bauco v Hilti)
[70] Case 53/92P Hilti AG v. Commission [1994] ECR I-667.
[71] Commission Decision of 20.06.2001 relating to a proceeding pursuant to Article 82 of the EC Treaty (COMP/E-2/36.041/PO-Michelin)

tyres to preserve or improve its position on the neighbouring retreads market.[72]

The case of *Hoffmann-La Roche*[73] concerned across-the-board rebates offered to customers who acquired the whole range of its vitamins. Therefore, the customers were dissuaded from acquiring any particular vitamins from other suppliers by the rebates. Moreover, a discussion of delivered pricing as a tie-in took place in *Napier Brown-British Sugar*.[74]

3.2 Comparing Art. 81 EC with Art. 82 EC

As a starting point, both Art. 81 and 82 EC pursue the aim of maintaining effective competition on the market with regard to exclusionary practices. Moreover, simultaneous use of these articles often occurs.[75]

Art. 81 EC prohibits agreements, decisions and concerted practices between undertakings, which have the object or effect of preventing, restricting or distorting competition. Such agreements are prohibited in particular where they concern tie-ins.[76]

Art. 81 (1) EC distinguishes between agreements that have as their object the restriction of competition and those that restrict competition by effect. Agreements that are restrictive due to their object are likely to harm consumer welfare and, henceforth, a per se approach is taken. An agreement caught by Art. 81 (1) EC can, nevertheless, still be defended under Art. 81 (3) EC, if it meets its four conditions.[77]

In the context of Art. 81 EC, for tying to cause competitive harm, three requirements must be satisfied. First, there must be significant market power in respect of the tying product. Since the application of Art. 81 EC is now also linked to significant market power in the market for the tying product, the analysis under Art. 81 EC and Art. 82 EC is now essentially similar. Secondly, the customer must be coerced to take the products as a package. If the customer had, the option to purchase the products separately there is usually no tie. Thirdly, the conditions in the market for the tied product must be such as to make competitive harm likely in that market, for example foreclosure.[78]

The balancing of the innovative benefits of an agreement against any risks that it might deny access to a particular market to existing competitors and new entrants takes place under Art. 81 (3) EC. An exemption can be obtained through qualification under one of the groups or block exemptions issued by the European Commission, or through convincing a national court or competition authority that the agreement is exemptible by applying the

[72] Whish, Richard: page 728.
[73] Case C-85/76 Hoffmann-La Roche v Commission [1979] ECR 461.
[74] Whish, Richard: page 728. See also Commission Decision of 18.07.1988 relating to a proceeding under Article 86 of the EEC Treaty (Case No IV/30.178. Napier Brown – British Sugar)
[75] DG Competition discussion paper page 5.
[76] Anderman, Steven D.: page 76.
[77] Whish, Richard: page 195-196.
[78] Anderman, Steven D. & Kallaugher, John: page 197-198, 279

Block Exemption Regulation[79] by analogy, with the help of the relevant guidelines accompanying the regulation. Agreements falling within the block exemption are said to have met the conditions stipulated in Art. 81 (3) EC, while individual block exemptions require an examination of the pro-competitive and anti-competitive effects of an agreement before it is regarded as exemptible.[80]

In the context of Art. 81 EC, agreements of minor importance and SMEs are exempt because they do not affect the trade between EU Member States to an appreciable extent. If the relevant market share does not exceed the 30% market share threshold on both the market of the tied product and the market of the tying product stipulated in the Block Exemption Regulation.[81]

Nonetheless, an agreement that is exempted under Art. 81 EC, whether by individual or block exemption, still subjects the conduct of the parties to the agreement to the parallel prohibition in Art. 82 EC. There may be a question as to whether Art. 81 EC is applicable in the absence of a contractual tie, the application of Art. 82 EC is not questioned since it applies to purely unilateral activity.[82]

Moreover, under Art. 82 EC the practice of exemption does not exist, since its aim is the protection of the individual's economic freedom as a value in itself against any impairment caused by excessive market power. In contrast to Art. 81 EC, which is more about an economics-based approach. There are possible objective justifications and efficiency defences in Art. 82 EC cases that could outweigh the negative effects on competition, i.e. if the practice generates efficiencies and the other conditions of Art. 81 (3) EC are satisfied. However, the European Courts may object to such an expansive interpretation of Article 82 EC.[83]

3.3 Conclusion

According to Art. 82 EC, abusive behaviour by a dominant undertaking within the common market or a substantial part of it shall be prohibited. Such abuse may in particular consist in making the conclusion of contracts subject to acceptance by the other parties of supplementary obligations that by their nature or according to commercial usage, have no connection with the subject of such contracts.

However, Art. 81 (1) (e) EC lays down a general prohibition on anti-competitive agreements or measures which make the conclusion of contracts subject to acceptance by the other parties of supplementary obligations

[79] Commission notice of 13 October 2000: Guidelines on vertical restraints [COM(2000/C 291/01) OJ C 291 of 13.10.2000].
[80] Anderman, Steven D.: page 79.
[81] Commission notice of 13 October 2000: Guidelines on vertical restraints, page 4, 43. See also Commission Regulation 2790/99 of 22 December 1999 on the application of Article 81 (3) of the Treaty to categories of vertical agreements and concerted practices [1999] OJ L336/21.
[82] Anderman, Steven D. & Kallaugher, John: page 279-280.
[83] Van den Bergh, Roger J. & Camesasca, Peter D.: page 249-250.

which, by their nature or according to commercial usage, have no connection with the subject of such contracts.

Here one is faced with two provisions, both applicable to the practice of tying and bundling. At a first glance, there seems to be no major difference between them and, in a sense, it may be true. It is possible to apply both provisions simultaneously to situations of tying and bundling. Still, when examining them in depth, certain characteristic differences appear. First, with regard to fulfilling necessary conditions for the applicability of either provision distinctions arise. The conditions for the applicability of Art. 81 (1) EC that differ from Art. 82 EC are numerous, starting with undertaking. There is a condition of multilateral behaviour, i.e. more then one undertaking must be involved. If the behaviour in question is a unilateral one Art. 81 (1) EC is not applicable, however, Art. 82 EC may be. Second, it must concern anti-competitive agreements or measures. Third, the anti-competitive agreements or measures must have the object or effect of preventing, restricting, or distorting competition. Anti-competitive agreements or measures that have the object of distorting competition are approached by a per se rule because they are more likely to harm consumers. Fourth, agreements caught by Art. 81 (1) EC can, nevertheless, still be defended and exempted under Art. 81 (3) EC.

Art. 82 EC requires the undertaking to be in a dominant position and the behaviour must have deviated from competition on the merits or normal competition. Furthermore, there is no possibility for exemption under this article. However, according to case law, the state of tying and bundling is more flexible. The policy of the European Commission has not been limited to the wording of Art. 82 (d) EC, but has been interpreted to include tying, pure bundling and mixed bundling. In addition, for tying and bundling to be in violation of Art. 82 (d) EC five elements have to be fulfilled. One of these elements is, surprisingly, that the undertaking can justify its behaviour and escape condemnation, i.e. exemption.

This extensive interpretation is possible because the EC Treaty is broad and the language is non-specific, leaving to the European Commission and the European Courts to put flesh on the bones. Yet, under this approach, a danger exists that practices that have little anti-competitive effects are prohibited. In this respect, competition law limits competition and the structure of Art. 81 EC, which takes into account that even anti-competitive agreements or measures can be justified. Therefore, Art. 81 EC is easier to understand and is better for business. For instance Art. 81 (3) EC balances the innovative benefits of an agreement against any risks that may occur by denying access to a particular market to existing competitors and new entrants, by providing opportunities for block exemptions or individual exemptions.

Art. 81 (1) EC address the fact that tying and bundling can have both pro-competitive and anti-competitive effects more than Art. 82 EC. More specific and clearer provisions are needed in order not to include tying and bundling that might not have anti-competitive effects. This is a matter for the case law to solve.

4 CFI vs Microsoft Corporation

The European *Microsoft* case, regarding Microsoft's practice of tying and bundling has generated enhanced interest in the application of EC law to tying abuse. Some claim that EC competition law is too rigid when dealing with practices of tying and bundling by dominant companies.[84] This chapter examines the conditions that the European Commission and the CFI have applied in finding tying and bundling as abusive under Art. 82 EC.

4.1 Background

Microsoft Corporation designs, develops and markets a wide variety of software products for different kinds of computing devices, including OS and streaming media players.[85]

In 1998, Sun Microsystems lodged a complaint with the European Commission. Two years later, the Commission launched an investigation on its own initiative relating to the integration of WMP into the Windows client PC OS. The Commission found Microsoft in violation of Art. 82 EC by abusing its dominant position.[86]

The Commission identified three separate product markets, one of them being the market for streaming media players. Media players are software products capable of reading audio and video content in digital form, while those with streaming capabilities are also capable of reading audio and video content streamed, i.e. transmitted across the Internet. The Commission determined that the geographic market had a worldwide dimension for the three product markets.[87]

The Commission stated that Microsoft maintained a dominant position, a dominant position with extraordinary features, meaning that Windows is not only a dominant product on the market for client PC OS, but, in addition, it is also the standard in the market for those systems. The assessment by the Commission that concluded that Microsoft held a dominant position was based on the following factors:[88]

- Microsoft's market shares was of over 90%
- There were significant barriers to market entry, owing to indirect network effects deriving, first, from the fact that users like platforms on which they can use a large number of applications and, second, from the fact that software designers write applications for the client PC OS that are the most popular among users.

Microsoft had abused its dominant position by tying the Windows client PC OS and WMP. Acquisition of the Windows client PC OS was conditional on the simultaneous acquisition of the WMP software from

[84] Dolmans, Maurits & Graf, Thomas: page 225.
[85] Case T-201/04, *Microsft Corp. v Commission*, para. 1.
[86] Ibid. para. 6, 10, 20, 21.
[87] Ibid. para. 23, 28-29.
[88] Ibid. para. 31-32.

1998 until 1999. Additionally, Microsoft sold Windows with streaming media players produced by other producers or by itself as options. According to the Commission, the new practice of tying was abusive for several reasons. First, Microsoft had a dominant position on the client PC OS market. Second, according to the European Commission, streaming media players and client PC OS were separate products. Third, Microsoft did not give consumers the opportunity to buy Windows without WMP. Fourth, the tying in question restricted competition on the streaming media player market.[89] Finally, the Commission ruled that Microsoft's rational for tying were not valid. Microsoft had argued that, first, the tying produces efficiency gains capable of offsetting the anti-competitive effects and, second, Microsoft had no interest in anti-competitive tying.[90]

Consequently, because of the two abusive practices Microsoft was fined 497 196 304, 00 Euros. Furthermore, with regard to tying, Microsoft had to offer a fully functional version of the Windows client PC OS, which did not incorporate WMP, although Microsoft retained the right to offer a bundle of the Windows client PC OS and WMP.[91]

Microsoft Corporation appealed the decision to the CFI and asked for annulment or reduction of the fine.

4.2 Tying and Bundling of Windows Media Player

Microsoft argued that the European Commission's five element presented in finding the tying in question an abusive practice departed from the conditions laid down in Art. 82 (d) EC.[92]

First, the Commission replaced the condition that the conclusion of contracts is "subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection" with the condition that "the dominant undertaking does not give customers a choice to obtain the tying product without the tied product".[93]

Second, the Commission added a foreclosure requirement, not expressly provided for in Art. 82 (d) EC. According to Microsoft, this was based on a new theory that the widespread distribution of media functionality in Windows would compel content providers to encode their content in Windows Media format (the format used by WMP). This would have the effect of excluding all competing streaming media players from the market and indirectly compel consumers to use only that media functionality.[94]

However, the Commission did not accept these arguments. The element of abuse was, according to it, not exhaustive but merely

[89] Ibid. para. 43-45.
[90] Ibid. para. 43-45.
[91] Ibid. para. 46, 49.
[92] Ibid. para. 842-844.
[93] Ibid. para. 845.
[94] Ibid. para. 846.

exemplified instances of abuse of a dominant position. Henceforth, bundling by an undertaking in a dominant position may also infringe Art. 82 EC where it does not correspond to the example given in Art. 82 (d) EC.[95]

CFI upheld the Commission's decision regarding the tying part of the issue, because the European Commission had correctly decided in the matter, in accordance with Art. 82 EC and the case law on this area.

4.2.1 Five Element

4.2.1.1 Dominance

The CFI started by stating that it was commonly accepted that Microsoft had a dominant position on the market for what was alleged to be the tying product, namely client PC OS. Microsoft enjoyed a 95 % market share worldwide through its Windows OS.[96]

4.2.1.2 Separate product

Microsoft argued that media functionality is not a separate product from the Windows client PC OS but forms an integral part of that system. Furthermore, consumers expected media players to be found within the client PC OS.[97]

The CFI acknowledged the fact that the separate product test posed difficulties. Consumers market perception changes over time. What seems to be a separate product may become a single product over time, both from a technological aspect and from the aspect of competition rules. The IT and communications industry, according to the CFI was a market with these features.[98]

Nevertheless, the CFI stipulated that consumer demand determine whether it is a separate product. According to relevant case law, if an independent demand for the allegedly tied product does not exist, then no separate product and no abusive tying can be spoken of.[99]

Microsoft claimed that complementary products did not constitute separate products for the purposes of Article 82 EC. However, this is contrary to EC case law. For example, in *Hilti* there was no demand for a nail gun magazine without nails, since a magazine without nails is useless. This, however, did not prevent the European Courts from concluding that those two products belonged to separate markets. With regard to client PC OS and application software, consumers may want to obtain the products together, but from different sources.[100]

In support of streaming media players, being a separate product is the fact that the market provides streaming media players separately and that there are vendors who develop and supply streaming media players on a stand-alone basis, separately from OS. Case law demonstrates that if they are on the market independent companies specialising in the manufacture

[95] Ibid. para. 861.
[96] Ibid. para. 870.
[97] Ibid. para. 912.
[98] Ibid. para. 913.
[99] Ibid. para. 917-918.
[100] Ibid. para. 921-923.

and sale of the tied product, it is evidence of the existence of a separate market for that product. Even Microsoft had a practice of developing and distributing versions of WMP for Apple's Macintosh and Sun Microsystems' Solaris OS. It also released upgrades of its streaming media player, distinct from the Windows OS. Further, Microsoft engaged in specific promotions of WMP, independent of the client PC OS. Finally, Microsoft had also sold the products separately before it started with tying.[101]

The consumer demand existed for the separate product, as a significant number of consumers choose to obtain streaming media players separately from their OS. Hence, consumers regarded the two products as separate. In addition, some users did not need or did not want a streaming media player, for example, companies that were afraid their staff might use them for non-work-related purposes.[102]

Another factor in favour of a distinct product argument was that client PC OS and streaming media players are different in terms of their functionalities. The Windows client PC OS is system software while WMP is application software. According to the European Commission, the two products involve different industry structures since Microsoft still has competitors on the streaming media player market, while on the client PC OS market the competition is insignificant. In addition, the price of the two products also point towards the two products being different.[103]

The fact that other vendors of competing client PC OS also bundled their system with a streaming media player is not determinative. Some vendors of non-Microsoft OS who supplied their OS with a streaming media player made the installation of the streaming media player optional, or allowed the removal of installation, or else offered a selection of different streaming media players. Case law showed also that even when tying two products is consistent with commercial usage, or that there is a natural link between the two products, the tying may still, nonetheless, constitute abuse, unless it is objectively justified.[104]

In conclusion, client PC OS and streaming media players constituted separate products according to the CFI.[105]

4.2.1.3 Coercion

Microsoft contested the fact that integrating WMP into the Windows client PC OS entailed coercion or supplementary obligations within the meaning of Art. 82 (d) EC. First, consumers paid nothing extra for the media functionality of Windows. Second, they were not obliged to use that functionality. Third, consumers could install and use competitors' streaming media players.[106]

Due to Microsoft's conduct, consumers were unable to acquire the Windows client PC OS without simultaneously acquiring WMP. Therefore,

[101] Ibid. para. 874-875, 879, 925, 927-930.
[102] Ibid. para. 876-877, 924, 932.
[103] Ibid. para. 880-881, 926.
[104] Ibid. para. 941-942.
[105] Ibid. para. 944.
[106] Ibid. para. 960.

the conclusion of contracts was made subject to the acceptance of supplementary obligations. The Original Equipment Manufacturers (OEMs) who licensed the Windows OS from Microsoft for pre-installation on a client PC were direct addressees of coercion and passed it on to end-users. Under Microsoft's licensing system, OEMs were to provide the Windows OS with WMP pre-installed. OEMs who wished to install a different streaming media player on Windows could do so only by adding it next to WMP. Furthermore, there were no technical means of uninstalling WMP, thus, the coercion was not just contractual in nature but also technical.[107]

The fact that consumers did not have to pay extra for WMP did not alter the situation because the price for WMP was included in the total price of the Windows client PC OS. Nonetheless, it did not follow from Art. 82 (d) EC or from case law that consumers had necessarily to pay a certain price for the tied product, or had to be compelled to use the tied product, for illegal bundling to result. If there was a risk that competition would be restricted, it was immaterial whether consumers had to buy or to use WMP. In *Hilti,* users did not need to use the Hilti branded nails, which they obtained with the Hilti branded nail gun.[108]

After considering, all of the foregoing considerations, the condition relating to the imposition of supplementary obligations was deemed by the CFI to have been satisfied in the present case.[109]

4.2.1.4 Distortion of Competition

Microsoft claimed that the European Commission had failed to prove that the integration of WMP into the Windows client PC OS involved foreclosure of competition. Its argument was that since the Commission was not dealing with a classical tying case, it had to apply a new theory. This theory would rely on a prospective analysis of the possible reactions of third parties, in order to be able to reach the conclusion that the tying at issue was likely to foreclose competition.[110]

The view of the CFI was that tying WMP forecloses competition in the streaming media player market. Windows bundled with WMP affected relations on the market between Microsoft, OEMs, and suppliers of third party streaming media players, and altered to an appreciable extent the balance of competition in favour of Microsoft and to the detriment of the other operators.[111]

In classical tying cases, both the European Commission and the Community Courts considered foreclosure demonstrated by the bundling of a separate product with the dominant product. In the present case, however, the Commission had to analyse whether tying WMP constituted a conduct liable to foreclose competition, because users could and did to a certain extent obtain third party streaming media players through the Internet, sometimes free of charge.[112]

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[107] Ibid. para. 945-946, 961-963.
[108] Ibid. para. 948-949, 967-970.
[109] Ibid. para. 975.
[110] Ibid. para. 1031-1032.
[111] Ibid. para. 1034.
[112] Ibid. para. 977, 1036.

The tied sale ensured that WMP was ubiquitous on client PCs worldwide. In support of this argument was the fact that Windows client PC OS was pre-installed on more than 90% of client PCs shipped worldwide. Because of the bundling, WMP enjoyed an unparalleled presence on client PCs throughout the world, since, it automatically achieved a level of market penetration corresponding to that of the Windows client PC OS, and did so without having to compete on the merits with competing products. No third party streaming media player could achieve such a level of market penetration without having the advantage in terms of distribution that WMP enjoyed because of Microsoft's production of and concurrent distribution with its Windows client PC OS. Neither the option of downloading streaming media players from the Internet, nor their acquisition through other distribution channels, including the tied sale of a streaming media player with other software or Internet access services and retail sale of streaming media players, could offset WMP's ubiquity. Attempts at downloading third party streaming media players were not always successful due to factors such as slow modem connection that some PC users had, and a number of users were also unaware of the downloading option. In addition, some users would not even want to try other streaming media players because they already had WMP pre-installed.[113]

The indirect network effects obtained in the streaming media player market and the ubiquitous presence of WMP code provided that streaming media player with a significant competitive advantage, with this being liable to having a harmful effect on the structure of competition in that market. The technology that content providers and software developers chose to develop their complementary software for is based on percentages of installation and use of streaming media players. Consequently, it was based in this case, on WMP, since it enabled them to reach all 90 % users of client PC users, and because otherwise it would have created additional costs to make their products available in more than one format. Although standardisation may have advantages, an undertaking in a dominant position by means of tying cannot impose it unilaterally.[114]

The ubiquity of WMP on client PCs also had spillover effects on certain aftermarkets, such as the market for streaming media players on wireless information devices, set-top boxes, Digital Right Management (DRM) solutions and on-line music delivery.[115]

Finally, Microsoft used Windows as a distribution channel to ensure for itself a significant competitive advantage on the streaming media player market, and bundling put Microsoft's competitors at a disadvantage even if their products might have been better than WMP. Thus, this disrupted the normal competitive process according to the CFI, the process which would have benefited users by ensuring innovation. Microsoft could instead expand its position in the streaming media player market and weaken effective competition to the detriment of consumers.[116]

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[113] Ibid. para. 979-982, 1038-1039, 1049-1050.
[114] Ibid. para. 983-986, 1044-1046, 1061.
[115] Ibid. para. 987.
[116] Ibid. para. 1088.

4.2.1.5 Objective and Proportionate Justification

Microsoft argued that bundling produced efficiency gains outweighing the resulting anti-competitive effects. First, Microsoft argued that bundling produces efficiencies related to distribution.[117]

OEMs customise client PCs with respect to both hardware and software in order to differentiate them from competing products and to meet specific consumer demand. As a result, the market would respond to the efficiencies associated with the purchase of a full package, i.e. hardware, OS and software applications such as streaming media players, and the market would also be free to offer the variety that consumers demand. In other words, Microsoft should offer one version with the streaming media player and one without, permitting OEMs or end users wishing to do so to install the product of their choice on their client PC as the first streaming media player.[118]

According to the CFI, Microsoft could not rely on economies of scale made by the tied sale of two products. Economies of scale would mean a saving on financial resources, thus additional resources will not be necessary for maintaining a distribution system for the second product. Ideally, consumers benefit because they do not have additional cost associated with the second purchasing, including selection and installation of the product. However, software licensing, such as that of streaming media players, already had a low distributions costs with regard to consumers and innovation.[119]

Microsoft was not at a competitive disadvantage when compared with most of its competitors who provided multimedia capabilities with their OS. First, because Microsoft could enter into agreements with OEMs to pre-install the Windows OS and a streaming media player to meet consumer demand. What was prevented was the tying practice, i.e. not allowing OEMs or consumers to obtain Windows without WMP or, at least, to remove WMP from the system consisting of Windows and WMP. Furthermore, tying had different affects on the market, depending on whether the undertaking was in a dominant position or not in a dominant position.[120]

Second, Microsoft argued that tying produced efficiencies related to WMP as a platform for content and applications.[121]

However, Microsoft did not bring forward enough evidence that the integration of WMP into Windows enhanced the technical performance of the product, or that it was indispensable in order to achieve pro-competitive effects.[122]

Microsoft could neither contend that the removal of WMP from the system consisting of WMP and Windows would have entailed a degrading of the OS.[123]

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[117] Ibid. para. 1092.
[118] Ibid. para. 1094, 1150.
[119] Ibid. para. 1095.
[120] Ibid. para. 1096, 1149.
[121] Ibid. para. 1097.
[122] Ibid. para. 1098.
[123] Ibid. para. 1165.

In conclusion, Microsoft was not able to demonstrate the existence of any objective justification for the abusive bundling of WMP with the Windows client PC OS, according to the CFI.[124]

If the competitive conditions on the market are right and the package deal does not prevent manufacturers of PCs from selling a PC package that contains one or more other streaming media players, and as long as buyers of client PCs are free to add further streaming media players to their PC, such practice could be said to be acceptable within the CFI's frame of reasoning. However, the Court did not find the competitive conditions to be right in this case.

4.2.1.6 Remedy

CFI ruled that Microsoft had to offer, within 90 days of notification of the decision, a fully functional version of its Windows client PC OS that did not incorporate WMP. However, Microsoft maintained the right to offer a bundle of the Windows client PC OS and WMP.[125]

In addition, Microsoft had to refrain from any commercial, technological, contractual, or financial terms making the unbundled version less attractive.

However, one could argue that as they stood, it was questionable whether the remedies ordered by the European Commission would rectify Microsoft's abuses. Few computer manufacturers and vendors purchased Microsoft's Windows XP N, a version of Windows XP unbundled from WMP. The failure of Windows XP N to generate any interest had effectively undercut the European Commission's decision, as vendors and consumers preferred the fully bundled product.[126]

This remedy, however, gave PC manufacturers the choice as to whether to install Microsoft's streaming media player onto their desktop, or that of another software manufacturer instead. The decision thus lies first with the PC manufacturer, but through that, the customer is able to decide which products to take.[127]

4.3 Conclusion

The CFI essentially upheld the European Commission's decision, in finding that Microsoft had abused its dominant position through its exclusionary abuse of tying and bundling.

The CFI stated that the distinctness of products for the purpose of an analysis under Art. 82 EC had to be assessed with reference to consumer demand. Furthermore, with regard to foreclosure, the CFI found that Microsoft offered OEMs only the version of Windows bundled with WMP. In this respect, Microsoft obtained an unparalleled advantage, regarding the distribution of its product. First, Microsoft ensured the ubiquity of WMP on client PC OS worldwide. Second, this created disincentives for users to

[124] Ibid. para. 1167.
[125] Ibid. para. 1232.
[126] Jennings, John P.: page 79.
[127] MacQueen, Hector & Waelde, Charlotte & Graeme, Laurie: page 858.

make use of third party streaming media players and for OEMs to pre-install such streaming media players on client PCs. Third, it weakened competition in such a way that the maintenance of an effective competitive structure was unsure in the near future. The finding of foreclosure was based on predictions about the future conduct of third parties and the future danger of tipping. In the aspect of foreclosure, the element of coercion was also said to be present. Finally, as regards objective justifications, Microsoft argued that tying enables software developers and Internet site creators to be sure that WMP is present on virtually all client PCs in the world. Thus, the European Commission considered the bundling led to the foreclosure of competing streaming media players from the market. Although the uniform presence to which Microsoft referred may have advantages for operators, that cannot suffice to offset the anti-competitive effects of the tying at issue, an argument subsequently upheld by the CFI.

A per se rule condemns certain behaviour on the market on the basis of the object or purpose without any extensive market analysis, while a rule of reason involves an economic analysis and a balancing of the pro-competitive and anti-competitive effects. In other words, the underlying reason behind the distinction is the need of distinguishing pro-competitive instances of tying and bundling from anti-competitive ones.

Before *Microsoft*, the European Commission dealt with tying and bundling through a modified per se prohibition, which involved examining market power, the existence of separate products and coercion. However, this view seems to have changed and in certain cases, it is necessary to consider also whether there is a restrictive effect on competition for the tied product, and whether there is an objective and proportionate justification for the coercion. In other words, one could speak of a shift towards a rule of reason approach by the European Courts in establishing whether the anti-competitive effects of tying outweigh any possible pro-competitive benefits.[128]

The rule of reason is also supported by the fact that Art. 82 EC requires the defendant to substantiate efficiencies to show that they cannot be achieved by less restrictive means, and to demonstrate that the efficiencies outweigh the anti-competitive effects. Furthermore, the five-element test itself can be said to reflect a rule of reason approach to tying and bundling.[129]

[128] O'Donoghue, Robert & Padilla, A Jorge: page 510.
[129] Ibid. page 511.

5 United States v Microsoft Corporation

5.1 Background

Besides the European Commission's investigation, Microsoft was also subject to an investigation for violation of U.S. antitrust law.[130]

The U.S. case on Microsoft started in 1994, when the Antitrust Division of the U.S. Department of Justice (DOJ), on behalf of the United States, filed a suit against Microsoft, charging the company with, unlawfully maintaining a monopoly in the OS market through anti-competitive terms in its licensing and software developer agreements. The parties subsequently entered into an agreement, with a consent decree being then issued by the authorities, thus avoiding a trial. Three years later, DOJ filed a civil contempt action against Microsoft in the U.S. District Court for Columbia, for allegedly violating one of the decree's provisions by bundling the IE web browser with its Windows 95 OS. After Microsoft appealed the resulting injunction to the U.S. Court of Appeals for the District of Columbia, successfully obtaining a stay concerning its bundling of IE with its new Windows OS 98 the United States of America, 20 individual States and the District of Columbia brought proceedings against Microsoft regarding four distinct violations of the Sherman Act in the U.S. District Court for Columbia. First, unlawful exclusive dealing arrangements in violation of § 1, second, unlawful tying of IE to Windows 95 and Windows 98 in violation of § 1, third, unlawful maintenance of a monopoly in the PC OS market in violation of § 2 and fourth, unlawful attempted monopolisation of the internet browser market in violation of § 2. The individual States also brought claims charging Microsoft with violations of various State antitrust laws.[131]

The US District Court, District of Columbia found Microsoft to be in violation of §§ 1 and 2 of the Sherman Act. These established facts mandated findings of liability under analogous state law antitrust provisions as well. Microsoft had maintained a monopoly in the market for Intel compatible PC OS in violation of § 2, attempted to gain a monopoly in the market for internet browsers in violation of § 2, and illegally tied two separate products, Windows and IE in violation of § 1. As a remedy against the Sherman Act violations, the District Court issued a Final Judgement requiring Microsoft to divide into two separate corporations, an operating system business and an application business. Until that happened, there was an interim restriction on Microsoft's commercial behaviour.[132]

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[130] Case T-201/04, *Microsft Corp. v Commission*, para. 51-52.
[131] *United States v. Microsoft Corp.*, 253 F.3d 34 (C.A.D.C.2001).
[132] *United States v. Microsoft Corp.*, 253 F.3d 34 (C.A.D.C.2001). See also *United States v. Microsoft Corp.*, 87 F.Supp.2d 30 (D.D.C.2000) for the District Court's judgement. See *United States v. Microsoft Corp.*, 97 F.Supp.2d 59 (D.D.C.2000) with concern to the remedy.

Microsoft appealed the decision to the U.S. Court of Appeal for the District of Columbia with regard to its legal conclusion and the remedial order specified in it.[133]

5.2 Tying and Bundling of Internet Explorer

The practice of Microsoft with regard to tying and bundling has three distinct parts, according to the U.S. Courts. First, Microsoft bound IE to Windows with contractual and, later, technological means in order to ensure the presence of IE on every Windows user's PC system, and to increase the costs attendant to installing and using rival Netscape's Navigator browser software on any PCs running Windows. Second, Microsoft imposed licensing restrictions, limiting the freedom of OEMs to reconfigure or modify Windows 95 and Windows 98. Third, Microsoft used incentives and threats to induce especially important OEMs to design their distributional, promotional, and technical efforts to favour IE to the exclusion of Navigator.

The Court of Appeal began first to examine whether the District Court had identified the proper market for the purpose of assessing Microsoft's monopoly power, because the offence of monopolisation in § 2 of the Sherman Act has two elements. First, possession of monopoly power in the relevant market and, second, the wilful acquisition or maintenance of that power as distinguished from growth or development because of a superior product, business acumen, or historic accident.[134]

The Appellate Court concluded that the District Court had properly defined the relevant market as the licensing of all Intel-compatible PC OS worldwide. According to the District Court, no interchangeable product exists that a significant percentage of computer users can use worldwide to substitute for these OS without incurring substantial costs. Moreover, there will likely not be any in the near future.[135]

In this relevant market, Microsoft possessed monopoly power. Microsoft's monopoly power existed because of its 95 % market share, and from the OS market structure, such as through the presence of network effects as barriers to entry. The characteristics of barriers to entry are that, first, most consumers prefer OS for which a large number of applications have already been written and, second, most developers prefer to write for OS that already have a substantial consumer base, for instance the already dominant Windows. Additionally, Microsoft's behaviour may have well been sufficient to show the existence of monopoly power.[136]

The second step was to determine whether Microsoft maintained or attempted to maintain a monopoly by engaging in exclusionary practice, such as tying and bundling. The court developed a four-part test to reach a conclusion. First, the monopolist's act must have an anti-competitive effect

[133] *United States v. Microsoft Corp.*, 253 F.3d 34 (C.A.D.C.2001).
[134] Ibid. page 30.
[135] Ibid. page 32.
[136] Ibid. page 34, 36-37.

in order for the practice to be condemned as exclusionary, i.e. harm the competitive process and thereby harm consumers. Second, the plaintiff, who has the burden of proof, must demonstrate that the monopolist's conduct harmed competition in general, not just the plaintiff qua individual competitor. Third, the monopolist may provide a pro-competitive justification for its conduct, i.e. arguing that its conduct is indeed a form of competition on the merits because it involves, for example, greater efficiency or greater consumer appeal. Then the burden of proof shifts back to the plaintiff to rebut that claim. Fourth, if the monopolist's pro-competitive justification stands unchallenged, then the plaintiff must demonstrate that the anti-competitive harm of the conduct outweighs the pro-competitive benefit. Finally, evidence of intent is relevant to understanding the likely effect of the monopolist's conduct. Nevertheless, when assessing the balance between the anti-competitive effect and pro-competitive effect, the focus is on the effect of the conduct.[137]

5.2.1 Maintaining Monopoly

The Appellate Court, using the abovementioned four-part test, addressed the District Court findings concerning Microsoft's engagement in four exclusionary types of practice and, consequently, found it to be in violation of the Sherman Act.

5.2.1.1 Licence Issued to Original Equipement Manufacturers

The Appellate Court looked at three restrictions that Microsoft placed upon OEMs.[138]

First, there is a prohibition on OEMs from removing any desktop icons, folders or Start menu entries. The OEM channel is one of the two primary channels for distribution of browsers. This licence restriction prevented many OEMs from pre-installing a rival browser, because more than one product in a given category can increase an OEM's support costs. The increased support cost refers to customers calling or otherwise contacting the OEM's support helpdesk because they are confused concerning the additional product. Consequently, Microsoft's monopoly prevented competition that middleware might have otherwise presented, and the licence restriction was deemed anti-competitive.[139]

Second, the OEMs had a restriction preventing them from altering the initial boot sequence. Prior to the imposition of that restriction, OEMs inserted into the boot sequence Internet sign-up procedures that encouraged users to choose from a list of Internet Access Providers (IAPs) assembled by the OEM. The prohibition had the effect of decreasing competition against IE by preventing OEMs from promoting browsers produced by Microsoft's rivals, and Microsoft did not deny this. This prohibition was also deemed

[137] Ibid. page 38-39.
[138] Ibid. page 40.
[139] Ibid. page 40-41.

anti-competitive, due to the substantial effect it had in protecting Microsoft's market power through means other than competition on the merits.[140]

Third, prohibition on OEMs existed, where they could not alter the appearance of Windows desktop. Prior to this, many OEMs would change the appearance of the desktop in ways they found beneficial. The anti-competitive effect of the licence restrictions was, as Microsoft itself recognised, that OEMs were not able to promote rival browsers, such a measure keeping developers focused upon the Application Programming Interfaces (APIs) in Windows.[141]

The justification put forward by Microsoft for the licence restrictions had to do with Microsoft exercising its IPRs, and that Netscape was not restricted from distributing Navigator. However, IPRs do not confer a privilege to violate antitrust laws. Yet, the second licensing prohibition was justified according to the Court, and outweighed the anti-competitive effects. The other OEM licence restrictions represented uses of Microsoft's market power to protect its monopoly.[142]

5.2.1.2 Integration of Internet Explorer and Windows

Microsoft took three actions concerning integrating IE and Windows.

First, it excluded IE from the Add/ Remove Program utility. Prior to this, Microsoft had included IE in the Add/ Remove Program utility in Windows 95. However, when it modified Windows 95 to produce Windows 98, it took IE out of the Add/Remove Program utility. This change reduced the usage share of rival browsers by discouraging OEMs from distributing rival products, and protected Microsoft’s own OS monopoly. Hence, it was deemed anti-competitive by the Appellate Court.[143]

Second, Microsoft designed Windows to override the user’s choice of a default browser other than IE. This practice reduced rivals' usage share and protected Microsoft's monopoly, with Microsoft not denying this fact. It deterred consumers from using a browser other than IE even if they preferred to do so. Consequently, it too was deemed anti-competitive.[144]

Third, Microsoft commingled the code related to browsing and other codes that provided OS functions in the same files. If someone attempted to delete the files containing IE, the OS would breakdown. The commingling deterred OEMs from pre-installing rival browsers, thereby reducing the rivals' usage share and, thus, reducing developers' interest in rivals' APIs as an alternative to the API set offered by Microsoft's OS.[145]

Microsoft provided no justification for two of the three challenged actions that it took in integrating IE into Windows. It failed to meet its burden of showing that its conduct served a purpose other than protecting its OS monopoly. Microsoft's exclusion of IE from the Add/ Remove Program utility and its commingling of browser and operating system code constituted exclusionary conduct, in violation of § 2 of the Sherman Act.

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[140] Ibid. page 41.
[141] Ibid. page 41.
[142] Ibid. page 42-43.
[143] Ibid. page 43-44.
[144] Ibid. page 44.
[145] Ibid. page 45.

With regard to the overriding of the user's choice of default browser in certain circumstances, Microsoft provided the Court with a pro-competitive justification that went unchallenged. It was argued that this practice was due to technical reason, which justified the override. The challenged act did not outweigh the pro-competitive effects.[146]

5.2.1.3 Other various conduct

5.2.1.3.1 Agreement with IAPs

The District Court condemned Microsoft's agreement with various IAPs[147] as exclusionary conduct. The Appellate Court examined the five actions that the District Court relied upon for the condemnation.[148]

First, Microsoft offered IE free of charge to IAPs. Second, it offered IAPs a bounty for each customer the IAP signed up for services using the IE browser. Third, Microsoft developed the Internet Explorer Access Kit (IEAK), a software package that allowed an IAP to create a distinctive identity for its service in as little as a few hours by customising the IE title bar, icon, start, and search pages. Fourth, the IEAK was offered to IAPs free of charge. Then, Microsoft extended valuable promotional treatment to the ten most important IAPs in exchange for their commitment to promote and distribute IE and to exile Navigator from the desktop. In exchange for their efforts to upgrade existing subscribers to client software that came bundled with IE instead of Navigator, Microsoft granted rebates or even payments to those same IAPs.[149] Fifth, Microsoft agreed to provide easy access to IAPs' services from the Windows desktop in return for the IAPs' agreement to promote IE exclusively and to keep shipments of internet access software using Navigator under a specific percentage, typically 25%. The Appellate Court addressed the first four items as inducements and the fifth as the exclusive agreements with IAPs.[150]

The Appellate Court considered the first four actions to be merely offering the consumers an attractive deal and could not, in its opinion, be treated as anti-competitive. The antitrust laws do not condemn even a monopolist for offering its product at an attractive price.[151]

The exclusive dealing agreement with the IAPs was, however, adjudged as being exclusionary and in violation of § 2 of the Sherman Act. It ensured that the majority of all IAP subscribers were offered IE either as the default browser or as the only browser. This had a significant effect in preserving Microsoft's monopoly and helped keep usage of Navigator below the critical level necessary for Navigator or any other rival to pose a real threat to Microsoft's monopoly. Microsoft did not provide any justification for its conduct either in this respect.[152]

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[146] Ibid. page 45-46.
[147] The IAPs include both Internet Service Providers, which offer consumers internet access, and Online Services ("OLSs") such as America Online ("AOL"), which offer proprietary content in addition to internet access and other services.
[148] *United States v. Microsoft Corp.*, 253 F.3d 34 (C.A.D.C.2001), page 46.
[149] Ibid. page 46.
[150] Ibid. page 46.
[151] Ibid. page 47.
[152] Ibid. page 49

5.2.1.3.2 Agreement with ICPs, ISVs and Apple

Next, the District Court tackled the issue of Microsoft dealing with Internet Content Providers (ICP), Independent Software Vendors (ISVs), and Apple.[153] Microsoft granted the ICPs and ISVs free licences to bundle IE with their offerings, as well as offering them other valuable inducements for obtaining their agreement to distribute, promote, and rely on IE rather than on Navigator. Consequently, such measures taken by Microsoft were held to be anti-competitive since they had the effect of directly inducing developers to focus on Microsoft's own APIs rather than the ones offered by Navigator.[154]

The Appellate Court, on the other hand, concluded that Microsoft's agreements with ICPs did not support a liability claim. There was no evidence that they had an impact on Navigator's usage share. With regard to the agreement with ISVs, the Court was of the opinion that the deals had an anti-competitive effect, and Microsoft did not manage to rebut the claim. In exchange for the favourable conditions given to ISVs by Microsoft, ISVs agreed to use IE as the default browsing software for any software they developed. Therefore, millions of consumers using applications designed by ISVs that entered into agreement with Microsoft would use IE rather than Navigator. This would foreclose a substantial share of the market for Navigator and preserve Microsoft's monopoly. Microsoft in its turn did not provide any pro-competitive justifications for its actions.[155]

The Appellate Court also found Microsoft to be in violation of § 2 of the Sherman Act with regard to the agreement with Apple. In support of this ruling, was the agreement entered between Apple and Microsoft, in which Microsoft agreed to release up-to-date versions of Mac Office. Apple, in its turn, was obligated to make IE the default browser instead of rival browsers. This had a substantial effect upon the distribution of rival browsers, and due to the absence of pro-competitive justifications the District Court's finding of § 2 liability was affirmed.[156]

5.2.1.3.3 Java

Java is a set of technologies developed by Sun Microsystems and it is a potential threat to Windows' position as the ubiquitous platform for software development. Microsoft took four steps towards diminishing the threat from Java. First, it designed a Java Virtual Machine (JVM) incompatible with the one developed by Sun Microsystems. Second, it entered into contracts requiring ISVs to promote Microsoft's JVM exclusively. Third, Microsoft deceived Java developers about the Windows-specific nature of the tools it distributed to them. Fourth, it coerced Intel to stop aiding Sun Microsystems in improving Java technologies.[157]

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[153] ICPs develop websites. ISVs develop software. Apple is an OEM and a software developer.
[154] *United States v. Microsoft Corp.*, 253 F.3d 34 (C.A.D.C.2001), page 49
[155] Ibid. page 50
[156] Ibid. page 51-52.
[157] Ibid. page 52.

With regard to the first action, the Appellate Court held that the incompatible JVM did not have an anti-competitive effect, which outweighed the pro-competitive justification for the design. A monopolist does not violate antitrust laws simply by developing a product that is incompatible with those of its rivals. The JVM allows applications tend to run more swiftly and does not itself have any anti-competitive effects. Furthermore, Microsoft's JVM allows Java applications to run faster on Windows than does Sun Microsystems' JVM. [158]

Concerning the other actions taken by Microsoft, the Appellate Court found them to be anti-competitive and in violation of § 2 of the Sherman Act. The record indicated that Microsoft's deals with ISVs had a significant effect upon JVM promotion. Regarding the Java developers' tools, the Appellate Court found that Microsoft's deception was intentional. Microsoft did not provide any pro-competitive justification for these actions. Intel designs and manufactures microprocessors, but also software. The company was about to develop a Windows-compatible JVM when Microsoft threatened Intel. If it did not stop giving aid, Microsoft would refuse to distribute Intel technologies bundled with Windows and support instead AMD, a competitor to Intel. Microsoft did not offer a pro-competitive justification for its treatment of Intel.[159]

5.2.2 Attempting Monopolisation

Microsoft challenged also the District Court's finding of liability concerning its alleged attempt at monopolisation. The establishing of a § 2 violation for attempted monopolisation requires the proof of (1) engagement in predatory or anti-competitive conduct with (2) a specific intent to monopolise and (3) a dangerous probability of achieving monopoly power. The third requirement also needs the relevant market defined and the demonstration of substantial barriers to entry. The plaintiffs made the same argument as under the maintaining of monopoly claim and the District Court accepted it. However, a claim regarding attempted monopolisation requires independent analysis. Because the plaintiffs did not carry their burden in defining the relevant market and showing the barriers to entry on that market, the Appellate Court reversed the District Court's ruling on this claim without remand.[160]

5.2.3 *Rule of Reason* or *Per Se Rule*

The District Court concluded that Microsoft's contractual and technological bundling of the IE web browser (the tied product) with its Windows OS (the tying product) resulted in a tying arrangement that was per se unlawful.[161]

There are four element recognised under U.S. to a per se tying violation. First, the tying and tied goods are two separate products. Second, the defendant has market power in the tying product market. Third, the

[158] Ibid. page 52-53.
[159] Ibid. page 53-55.
[160] Ibid. page 57-61.
[161] Ibid. page 61-62.

defendant affords consumers no choice but to purchase the tied product from it. Fourth, the tying arrangement forecloses a substantial volume of commerce.[162]

With regard to the separate product test in a *per se rule* approach the Court used a consumer demand test. There are two forms of the consumer demand test, one direct and one indirect. The direct consumer demand test focuses on historic consumer behaviour, likely before integration, and the indirect industry consumer test looks at firms that may not have integrated the tying and tied goods. Both are backward-looking and, therefore, poor proxies for overall efficiency in the presence of new and innovative integration. Consumers may be worse off using the per se rule approach and its consumer demand test. Nevertheless, the Appellate Court did not argue that Microsoft's integration was welfare-enhancing or that it should have been absolved of tying liability, but that the separate-product element of the per se rule may not give newly integrated products a fair chance.[163]

The US Supreme Court has warned that it is only after considerable experience with certain business relationships that courts classify them as per se violations. Technical integration has not been dealt with in prior antitrust cases and the application of a *per se* rule carries a serious risk of harm, i.e. a per se rule may produce inaccurate result and stunt valuable innovation. Hence, American courts, if they followed this line of reasoning, would not be yet able, at this point in time, to decide on such measures'.[164]

The failure of the separate-product test to screen out certain cases of product integration is particularly troubling in platform software markets. Not only is integration common in such markets, but it is also common among firms without market power. Firms without market power have no incentive to package different pieces of software together, unless there are efficiency gains from doing so. Moreover, because of the innovative character of platform software markets, tying in such markets, may produce efficiencies that courts have not previously encountered and, thus, the Supreme Court did not factor into the per se rule as originally conceived.[165]

In conclusion, the Appellate Court held that the rule of reason should govern the legality of tying arrangements involving platform software products and remanded the District Court's finding of a per se tying violation.

5.2.4 Remedy

The Appellate Court annulled the District Court's remedy decree. This occurred for several reasons, (1) the court failed to hold a remedy-specific evidentiary hearing involving disputed facts (2) the court failed to provide adequate reasons for its decreed remedies, and (3) the Appellate Court had revised the scope of Microsoft's liability and it was impossible to determine to what extent that should affect the remedies provisions.[166]

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[162] Ibid. page 62.
[163] Ibid. page 66.
[164] Ibid. page 66-70.
[165] Ibid. page 66-70.
[166] Ibid. page 73.

The District Court chose a structural remedy, i.e. that Microsoft should be split into an Operating System Business and an Application Business. However, the Appellate Court concluded that this split was not appropriate, because Microsoft was a unitary company, thus, it would be difficult to divide Microsoft into different parts. Furthermore, the Court was not convinced of the causal connection between Microsoft's exclusionary conduct and the company's position in the OS market.[167]

5.3 Conclusion

The Court of Appeal upheld the District Court's finding that Microsoft had acted illegally in protecting its monopoly but reversed the finding that Microsoft had illegally monopolised the Web browser market. However, it sent back to the lower court for reconsideration the question of whether Microsoft had illegally tied its dominant PC OS with its Web browser, as well as that concerning an appropriate remedy for Microsoft's violation.

The Appellate Court concluded that Microsoft prohibited computer manufacturers from modifying or removing pre-bundled icons and entries, which prevented the distribution of rival browsers and maintained IE's dominant position in the desktop market. In addition, Microsoft entered into agreement with IAPs and ISVs to promote IE exclusively and to use Microsoft's JVM instead of Sun Microsystems's Java programming.

The U.S. Court of Appeal rejected the argument from the lower courts that tying by a dominant player in the software industry should be subject to a per se prohibition. The reason behind it was the many benefits of bundled software, thus, a rule of reason standard, weighing the pro-competitive and anti-competitive effects of combining software features ought to be the legal standard. The Court stated that integration of new functionalities into platform software is a common practice and a per se approach may stifle innovation. It also mentioned that there is also a consumer demand for bundled items but not, however, for unbundled ones. Otherwise, a competitor could probably offer the two products separately and capture sales of the tying product from vendors that bundle.[168]

Bundled software acts as an incentive for new competitors to develop innovations that can take advantage of pre-existing software integrated into an OS.

However, the Court of Appeal did not reverse the District Court's conclusion that the tying practice of Microsoft violated U.S. antitrust law, but that it should have been considered under a rule of reason instead of a per se rule. Nonetheless, the Court of Appeal stated that Microsoft's argument could not justify its actions.[169]

Yet, until the Supreme Court re-examines its *Jefferson Parish* ruling, the assumption still applies that if the per se criteria are fulfilled, bundling arrangements may be found illegal. Under the *Jefferson Parish test*, four

[167] Ibid. page 81-82.
[168] Evans, David S. & Padilla, A. Jorge & Polo, Michele: page 512-513.
[169] Dolmans, Maurits & Graf, Thomas: page 237-238.

elements are the basis of the per se illegal tying.[170] Still, five elements are necessary for a claim of per se illegal tying. Although, they vary in different circuits, the five-part test demonstrates the per se illegal tying method best.[171]

Separate product
The tying and the tied goods are two separate products, meaning that the tied items cannot be mere components of a single product like pens and pen caps or cars and wheels.

According to the Supreme Court, to determine whether two items are separate products or one integrated product, a consumer demand test shall apply. No tying arrangement can exist unless there is a sufficient demand for the purchase of the tied product separately from the tying product. If it is customary for the company to combine certain products, then it is hard to prove a consumer demand. However, if it is uncommon, and it is the only company in its industry to combine, then separate demand for each product is likely to exist.[172]

Coercion
The company must have sold the tying product on the condition that the purchaser takes the seller's tied product, in the form of package discounts or technological tying. In other words, the company essentially forces consumers to purchase the tied product directly or indirectly.[173]

Tying market power in the tying product market
The defendant must have market power in the tying product. According to the U.S. Supreme Court, a 30 % market share is insufficient to establish the kind of market power necessary to trigger the per se rule against tying.

Foreclosure
The practice of tying must foreclose a substantial amount of competition in the tied product market.

Justification
Some instances, however, have moved on to examine objective justifications instead of finding the behaviour per se unlawful if the four elements were fulfilled. In other words, a per se approach involves also objective justifications requirement.

Tying can still escape condemnation in cases where the tie has a pro-competitive justification and the ties least restrictive alternative and offsets any anti-competitive harm.

The Court remanded the case, then negotiations between Microsoft and DOJ initiated, and this resulted in a settlement agreement. According to the agreement, Microsoft will not prohibit computer manufacturers and

[170] Ponsoldt, James F. & David, Christopher D.: page 426.
[171] Elhauge, Einer & Geradin, Damien: page 506-507. Hovenkamp, Herbert: page 397.
[172] Ponsoldt, James F. & David, Christopher D.: page 426-427.
[173] Hovenkamp, Herbert: page 410.

vendors from adding competing software programs, altering the desktop icon and shortcut layout, and installing boot sequences that divert users away from Microsoft products. Furthermore, Microsoft may not enter agreements with IAPs prohibiting the use of products that compete with Microsoft's IE (or any other Microsoft middleware product). Microsoft also cannot discriminate against IAPs, ISVs and ICPs who choose to use products that compete with Microsoft software. In order to prevent Microsoft from excluding competitors, the agreement also stipulated that Microsoft disclose information to ISVs on how its OS interoperated with any of its middleware products, thus allowing competitors to utilise Windows for their own programs. Finally, end-users may remove any Microsoft middleware products, such as IE, using the Add/ Remove Program utility, i.e. IE could effectively be unbundled from Windows.[174]

[174] Jennings, John P.: page 75-76.

6 Comparing the EU and U.S. Microsoft

Before commencing with a comparison of the EU and U.S. *Microsoft* decisions, we should keep in mind that divergences exist between these two legal orders.[175]

6.1 EC Competition Law and U.S. Antitrust Law

EC Competition law falls within the authority of the EU. It is an important part of ensuring the completion of the internal market: the four fundamental free movement rights of persons, goods, services, and capital. EC Competition law operates in part through Art. 82 EC, a system for ensuring that competition is not distorted in the common market. In order to achieve its aim, Art. 82 EC creates binding norms for all natural and legal persons in the Member States and it prevails over national law in case of conflict. The European Commission has the task of ensuring that the principles of EC competition law are enforced. To its aid, it has the National Competition Authorities (NCAs) and the judicial instances of the different EU Member States.[176]

On the other side of the Atlantic, is U.S. competition law – known as antitrust law. In the U.S., antitrust law is common law, whereas most jurisdictions in the EU follow civil law. In the US, the constitution's supremacy clause means that where federal and state conflict federal law is supreme. On the other hand, federal law often leaves room for state law, regardless of policy conflict and sometimes invite states to regulate.[177]

The primary sources of U.S. antitrust law are statutes enacted by the U.S. Congress, with the Sherman Act providing the basic laws condemning anti-competitive agreements in section 1 and unilateral conduct that monopolises or attempts to monopolise in section 2. In addition to the federal legislation on antitrust issues, states also have their own antitrust statutes. However, states tend to enforce state antitrust law less stringently than the enforcement of antitrust law at the federal level. Furthermore, they are generally ancillary claims to US antitrust claims, which must be in federal courts. Nevertheless, state antitrust law is free to prohibit conduct that federal antitrust law allows.[178]

Important objectives for the antitrust regulations are protecting consumer welfare and ensuring opportunity for entrepreneurs to compete in

[175] Jones, Alison & Sufrin, Brenda: page 21.
[176] Treaty Establishing the European Community (Consolidated version in accordance with the Treaty of Nice, OJ 2002 C 325/1-184 (EC), Art. 2 EC and Art. 3 (1) (g) EC. Craig Paul, de Burca Grainne: page 950 and onwards.
[177] Anderman, Steven D.: page 125.
[178] Elhauge, Einer & Geradin, Damien: page 4, 7. Jones, Alison & Sufrin, Brenda: page 19.

the market economy. The U.S. Federal Trade Commission (FTC) and DOJ enforce the federal antitrust laws.[179]

6.2 The Treatment of Microsoft by U.S. and EU Regulators

EU and U.S. regulators have spent time and resources on investigating Microsoft over the past decade and the effect on competition of its practices. The American case focuses on the browser and Java problem, whereas the European case concentrated on the integration of the streaming media player into the OS.[180] In the U.S., a lower District Court handed a harsh sentence ordering Microsoft as company to be broken up into two entities because of their violation of antitrust legislation. The Appellate Court, however, overturned the decision and remanded the case to the lower District Court. Yet, Microsoft entered into a settlement with the U.S. government and many critics have considered the outcome as being too lenient. In contrast, the European Commission, the decision of which was upheld by the CFI, imposed a heavy fine and required Microsoft to change key elements of its OS-related and general business practices.[181]

The EU and U.S. proceedings share a common starting point in the sense that both state that Microsoft holds a dominant position in the market for PC client OS. This dominant position was abused through the practice of tying and bundling, in order to preserve high barriers to entry in the relevant market.

U.S. case law, through the *Jefferson Parish* judgement mentioned earlier, has adopted a four-pronged approach as the legal standard for assessing tying and bundling in the software market. First, a monopolist's act must have anti-competitive effects in order to be condemned as exclusionary, i.e. harm the competitive process and thereby the consumers. Second, the plaintiff having the burden of proof must demonstrate that the monopolist's conduct has the requisite anti-competitive effects. Third, the monopolist may demonstrate pro-competitive effects stemming from its conduct, such as effects involving greater efficiency or enhanced consumer appeal. The burden of proof shifts back to the plaintiff to rebut the claim. Fourth, if the monopolist's pro-competitive justification stands unchallenged then the plaintiff must demonstrate that the anti-competitive effects of the conduct outweigh the pro-competitive benefits.[182]

This differs from the EU approach with its five-element test of dominance, separate product, coercion, foreclosure and objective and proportionate justification. These five requirements imply a modified per se illegality test, whereas some argue that the EU and the European Commission has mowed away from a per se rule, with dominance, separate product and coercion, to a rule of reason approach, including as well

[179] http://www.ftc.gov/speeches/other/dvspeech.shtm, 11 September, 2008. 11:33. http://www.ftc.gov/opa/2007/04/ipreport.shtm, 11 September, 2008. 11:40.
[180] Heinemann, Andreas: page 75.
[181] Jennings, John P.: page 72.
[182] Van den Bergh, Roger J. & Camesasca, Peter D.: page 272, 275.

foreclosure and objective and proportionate justification. Before the *Microsoft* case foreclosure effect had been considered satisfied only by demonstrating the bundling of a separate product with a dominant product. The *Microsoft* case, however, was different in the sense that consumers had the possibility of downloading streaming media players free. Hence, a more extensive analysis on the effects that the tying of WMP had on competition was required.

It is difficult to draw any conclusive answer whether the approach in EU can be said a per se or a rule of reason approach. These legal terms originate from U.S. Antitrust law and due to differences between the antitrust laws in the U.S. and the EU, a transfer of terminology renders difficulty. One might argue that it is a rule of reason approach but we do not call it rule of reason.[183]

The Court of Appeal considered that a per se rule would have the risk of condemning ties that may be welfare-enhancing and pro-competitive. Hence, they remanded the case to the lower District Court to be analysed under a rule of reason approach. First, the U.S. analysed the effects of the conduct in the market instead of just presuming that the conduct was anti-competitive. Second, an examination of objective justifications took place.[184]

The cases differ, however, with regard to the consumer demand test. The Court of Appeal rejected the consumer demand test for the separate product element, on the ground that it limited innovation. The reason is that the test fails when applied to new technology, i.e. technological software bundling. An innovative product creates its own demand *ab initio*. The test of *Jefferson Parish* focuses on demand for the tied product when introduced and taking into account the condition of the market before the bundle can affect consumer demand. CFI stated also that the consumer demand test is a poor evidentiary factor to use when determining whether a product is separate or not. Still, the CFI used the same test when determining whether WMP was a separate product or not.[185]

In addition, the Court of Appeal imposes a modest burden on defendants to demonstrate efficiencies, instead imposing the burden on the plaintiff to demonstrate that anti-competitive effects outweigh pro-competitive ones. In the EU, it is the defendant's burden to substantiate efficiencies to show that less restrictive means are not available and to demonstrate that the efficiencies outweigh the anti-competitive effects.[186]

In conclusion, both the U.S. and the EU recognise the fact that tying and bundling can have pro-competitive effects. Nevertheless, the approach adopted vis-à-vis Microsoft was harsher in Europe than in U.S.

The next divergence in the two jurisdictions' approach was as regards finding the optimal remedy, a remedy that aims at stifling the anti-competitive effects of the innovative conduct without eliminating the pro-competitive effects that this behaviour still generate.[187]

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[183] Craig Paul, de Burca Grainne: page 966.
[184] Van den Bergh, Roger J. & Camesasca, Peter D.: page 272, 275.
[185] Ponsoldt James F. & David, Christopher D.: page 437.
[186] Ibid. page 426.
[187] Montagnani, Maria Lillá: page 632.

Fines have the goal of preventing infringers from further adopting anti-competitive behaviour as well as deterring all market operators from implementing similar conduct. Hence, calculating the right level is crucial. With regard to the fine in the EU *Microsoft* case, it was deemed not high enough by some to discourage the infringer from similar behaviour. The reason is that companies can recoup the cost for fines by raising the prices for consumers, especially in the case of companies in the technological sector, which are likely to continue their activities because they can recoup on final prices. Furthermore, it is questionable whether such form of remedy can lower barriers to entry and make IPRs perform their function of providing incentives to innovate, especially if other remedies are not included.[188]

A second means available to protect and promote competition is structural remedies, which in the U.S. *Microsoft* case were imposed by the District Court, but subsequently reversed by the Court of Appeal.[189]

The third option used in *Microsoft* was unbundling. In the U.S. consent decree, the unbundling agreement occurred in order to limit visibility of IE in Windows, by requiring computer sellers to hide visible means of access to it. In this way, IE remained present in Windows and able to be activated upon request by a skilled consumer or by a third party. The CFI required Microsoft to engage in mandatory versioning and in offering computer sellers versions of Windows with and without WMP.

In the American consent decree, Microsoft was obliged to dissolve exclusive dealings contracts and to permit OEMs or end-users to remove the symbol for the bundled software from the desktop or the program list by putting it on the Add/ Remove list. However, Microsoft can continue product integration by adding new software to the OS. The U.S. Court of Appeal stated that it is not the task of the court to control product design. In Europe, a simple solution of end-user access without removing the WMP software from the computer completely was not sufficient. As long as WMP is present, applications would be able to call upon this software. Using Windows as a distribution channel by bundling the streaming media player with the OS ensures an anti-competitive advantage, irrespective of whether the Microsoft streaming media player is better than competing products.[190]

Various theories can explain the different outcome. The factors taken into considerations are political, focus of competition policy etc. It is difficult to pinpoint the underlying reason for these differences, but most likely, political, economical, social factors and legal rules have played its part.

[188] Ibid. page 634-635.
[189] Ibid. page 635.
[190] Heinemann, Andreas: page 78-79.

7 Analysis

The aim of this thesis was to answer when do tying and bundling go from having pro-competitive effects to having anti-competitive effects, and what are the proper remedies against anticompetitive effects?

These questions relate to the interaction between competition law and IPRs. Both fields share common objectives of promoting consumer welfare and efficient allocation of the resources. However, potential conflicts arise owing to the means used by competition law and those used by IPRs to promote their respective goals, such as tying and bundling. This conflict is evident in the software market.

From the perspective of the IPR owner, tying and bundling is simply one method of exploiting the IPR, and it is the most common practice used in the software industry. In the eyes of competition law, however, tying and bundling is an exclusionary and abusive practice. For example, if the IPR owner is dominant on the market, tie-ins may force customers to choose products they would rather not have or to exclude competitors and eventually foreclose competition in a second related market. The tying creates a competitive advantage for the IPR owner, compelling competitors to have access to both markets if they are to compete on equal terms with the IPR owner.[191]

The EU and U.S. *Microsoft* cases address these questions. Case law and legal doctrine is also the only material we can turn to in order to come to a conclusive answer to the questions posed. The legal provisions of Art. 82 EC and Art. 81 EC do not provide us with an answer to these questions. They are rather unspecific and broad, and it is up to the EU institutions to put flesh on the bones and give an appropriate specific circumstantial interpretation.

There are established theories both in support of the notion of tying and bundling as resulting predominantly in pro-competitive effects, as well as supporting the counter-notion that more anti-competitive effects result in the end from such practices. Both schools of thought are, however, not waterproof and a number of problems are always encountered whenever applying one or the other.

Based on case law, such as *Hilti* mentioned earlier, in the EU there are three elements that have to be fulfilled in order for tying and bundling to be considered as anti-competitive. However, these elements are based on an evaluation by the courts of more traditional industries, which can be said to behave differently from the software industry. The question presented then becomes why European Competition Law still treats more traditional industries as well as the software industry in the same manner. Bundling products in the software market is no differently than bundling products in more traditional industries, as when one tackles, for example, a much simpler argument concerning hammer and nails. The case of *Hilti* clearly deals with products that are entities physically separate from each other. Moreover, *Hilti* revolves around a main product where the undertaking

[191] Anderman, Steven D.: page 72.

producing it has a dominant position and the tying concerns a product that is consumable.[192]

The EU and U.S. rules that one must focus on consumer perception in order to determine whether products are integrated or separate is backward-looking, instead of being forward-looking and examining whether tying improves the technology in question or not. This prohibits revolutionary bundles, which have not yet displaced the demand for the previously separate components. The U.S. Court of Appeal, however, recognised the problem with the separate product test and did away with it. However, such an approach still lacks an appropriate measure of guidance to the courts in deciding, in that it still remains difficult for the judge to be able to know whether a business decision being challenged would be an abusive practice of tying and bundling or not.[193]

A point that could, however, be considered positive in this debate is that the *Microsoft* cases show a changing attitude in the approach towards tying and bundling. The approach concerns the question of whether it should be a *rule of reason* or a *per se rule* approach that should be adopted by authorities and the courts when tackling such issues in the future.

The rule of reason and the per se rule are two concepts originating from American antitrust law. A per se rule prohibits certain acts without regard to the particular effects of the acts, i.e. no investigation into the question of possible pro-competitive effects. One reason is that a per se prohibition is justified for types of conduct that have manifestly anti-competitive implications and a very limited potential for pro-competitive benefits. A rule of reason, on the other hand, is about investigating the effects of the challenged conduct, taking into account the particular facts of the case. The courts must decide whether the questioned practice imposes an unreasonable restraint on competition taking into account a variety of factors, including specific information about the relevant business, its conditions before and after the restraint was imposed and the restraint's history, nature and effect. The scope of the rule of reason varies dependent on Competition law's underlying goals in approaching the issue at stake.[194]

The Courts on both sides of the Atlantic recognise the fact that tying and bundling can have pro-competitive effects. Nevertheless, the CFI accepted the European Commission's five elements, even though the separate product test has been heavily criticised. This test is considered a poor indicator for net efficiency with regard to newly integrated products in the software market, where integration is common both by undertakings with market power and those without market power. The first firm to merge previously distinct functionalities or to eliminate the need for a second function risk being condemned as having tied two separate products. The reason is that during the integration of the product there will appear to be a distinct market for the tied product.[195] For example, Microsoft also has a dominant position for word processing programs that integrates a dictionary with several languages into its program. This will hamper independent

[192] Ponsoldt, James F. & David, Christopher D.: page 449-450.
[193] Ibid. page 450.
[194] Hovenkamp, Herbert: page 409.
[195] O'Donoghue, Robert & Padilla, A Jorge: page 512.

producers of electronic dictionaries. In such situations, an obligation to offer a large number of different versions of software would be required, for example, with or without WMP, with or without a web browser, with or without dictionaries, etc. Where should the line be drawn? Integration of new functions into the Windows OS is a serious threat to competing products. However, this should not stop the further development of the successful main product, because it would stifle innovation.[196]

Despite all this, the Courts in both the EU and the U.S. are more in favour of a per se approach, even if it can be said to be an inappropriate approach that undermines effective analysis of the function of tying arrangements. A per se approach, whether strict or modified, does not make economic sense, compared with the rule of reason, since tying and bundling are a constant feature of economic life, engaged in by all firms, and a per se approach does not take into account a balancing of pro-competitive and anti-competitive effects. The facts never really match up with the assumptions of economic models and other explanations are plausible and have to be sought in such situations.[197]

In my view, the approach of the Court should start from the view that the practice of tying and bundling is pro-competitive, i.e. a presumption of the pro-competitive effects of tying and bundling. However, when the exploitation of IPRs becomes a means of limiting competition on the market, then there is diminished incentive to create innovate products and intervention from Competition law is needed in order to maintain open markets, as well as to ensure that the innovation process remains ongoing. For example, suppliers of the tied product on a stand-alone basis might be able to innovate or improve the tied product in a way that the monopolist would have less incentive to do, or may not have the knowledge to do.[198]

The plaintiff must provide strong evidence that tying does not result in pro-competitive efficiencies, but is instead used to obtain or maintain a monopoly, or that there are significant anti-competitive effects that outweigh pro-competitive effects, i.e. a balancing-test where the anti-competitive effects are weighed against the pro-competitive benefits. The evidence would require a causal link between the practice and a likely reduction in consumer welfare. If anti-competitive effects outweigh the pro-competitive effects then it is up to the defendant to provide objective and proportionate justification for the anti-competitive practice of tying and bundling.

The aim of both the European as well as the American Court in the *Microsoft* cases was to maintain an open market, lower entry barriers in order to protect current and potential competition and promote innovation within the market. In other words, the question was one of finding a proper remedy against tying and bundling that has anti-competitive effects, without restraining incentives to innovate. A remedy that can achieve this is a complex task to find because there is no optimal remedy. Instead, one has to combine different remedies that suit the aim of maintaining open markets

[196] Heinemann, Andreas: page 79-80.
[197] O'Donoghue, Robert & Padilla, A Jorge: page 512-513. Ridyard, Derek: page 316.
[198] Montagnani, Maria Lillá: page 631, 624. Dolmans, Maurits & Graf, Thomas: page 233.

while at the same time promoting innovation. Thus, a case-by-case basis evaluation is necessary, since there is no general correct answer.

According to the CFI, unbundling is an appropriate remedy. However, it is doubtful whether the obligation to offer two different versions of Windows will achieve the objective of having fewer end-users equipped with WMP. Nevertheless, this leaves Microsoft with a large strategic scope, i.e. Microsoft could charge the same price for Windows with or without the WMP. Most likely, customers will choose the version with WMP.[199]

In this respect, the U.S. solution is favoured by placing the WMP on an Add/ Remove list. This measure would guarantee market access to competitors, thus, competition on the merits without restricting the possibilities of the dominant enterprise to improve its own product. The obligation to distribute competing products is more adapted to the specific problems of network industries than unbundling.[200]

In conclusion, a more appropriate remedy would have been a must-carry obligation. This would require Microsoft to distribute both the integrated product as well as competing products at the request of the competitors. Competing streaming media players would in this respect benefit from the network effect, which Microsoft has on the main market. Still, determining which remedy the courts in every specific case should choose should be carried out on a case-by-case basis, and based on objective criteria. Both unbundling and a must-carry obligation keep markets open, but unbundling runs the risk of stifling the innovation that integration can generate, which a must-carry obligation does not. The way in which unbundling may stifle innovation is by restraining functionalities of adjacent markets from integration into a sole product.[201]

Any conclusive answer to the questions posed in this chapter is difficult to give. There is a changing attitude. The Court of Appeal recognised the fact that tying and bundling might have pro-competitive effects and remanded the case to the lower court to decide it based on a rule of reason approach. One might argue that we also are moving in EU towards a rule of reason approach, because in the case of *Microsoft* the European Commission and CFI examined whether there was foreclosure on competition. Furthermore, they also examined possible objective and proportionate justifications. This is recognition that tying and bundling can have pro-competitive effects. Another positive aspect is the Court of Appeal doing away with the highly criticised consumer demand test.

Despite the changing attitude towards tying and bundling, as can be seen in the case of Microsoft, the U.S. Court of Appeal and the CFI decided the case of Microsoft. Until the highest judicial instances, the Supreme Court in the U.S. and ECJ in the EU, have ruled as to what principle should apply to tying and bundling in the software market, the old principles still apply. In the U.S., the *Jefferson Parish* test with its separate product element and consumer demand test. While for the EU, the notions laid down in *Hilti* and *Tetra Pak*. The latter two cases can be criticised due to the fact that the principle applied in each of them was based on more traditional

[199] Heinemann, Andreas: page 79.
[200] Ibid. page 81.
[201] Montagnani, Maria Lillá: page 640-642. Heinemann, Andreas: page 81.

industries. The CFI applied the principle as decided in these cases to the software industry, without distinguishing the characteristics of the software industry from those of more traditional industries.

Supplement A – EC Competition Legislation

Article 2[202]

"*The Community shall have as its task, by establishing a common market and an economic and monetary union and by implementing common policies or activities referred to in Articles 3 and 4, to promote throughout the Community a harmonious, balanced and sustainable development of economic activities, a high level of employment and of social protection, equality between men and women, sustainable and non inflationary growth, a high degree of competitiveness and convergence of economic performance, a high level of protection and improvement of the quality of the environment, the raising of the standard of living and quality of life, and economic and social cohesion and solidarity among Member States.*"

Article 3[203]

1. For the purposes set out in Article 2, the activities of the Community shall include, as provided in this Treaty and in accordance with the timetable set out therein:

[…]

c) an internal market characterised by the abolition, as between Member States of, obstacles to the free movement of goods, persons, services and capital;

[…]

g) a system ensuring that competition in the internal market is not distorted;

Article 81[204]

1. The following shall be prohibited as incompatible with the common market: all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the common market, and in particular those which:

a) directly or indirectly fix purchase or selling prices or any other trading conditions;

[202] Treaty Establishing the European Community (Consolidated version in accordance with the Treaty of Nice, OJ 2002 C 325/1-184 (EC).
[203] Treaty Establishing the European Community (Consolidated version in accordance with the Treaty of Nice, OJ 2002 C 325/1-184 (EC).
[204] Treaty Establishing the European Community (Consolidated version in accordance with the Treaty of Nice, OJ 2002 C 325/1-184 (EC).

b) limit or control production, markets, technical development, or investment;
c) share markets or sources of supply;
d) apply dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;
e) make 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. Any agreements or decisions prohibited pursuant to this Article shall be automatically void.

3. The provisions of paragraph 1 may, however, be declared inapplicable in the case of:
- *any agreement or category of agreements between undertakings;*
- *any decision or category of decisions by associations of undertakings;*
- *any concerted practice or category of concerted practices,*

which contributes to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit, and which does not:

a) impose on the undertakings concerned restrictions which are not indispensable to the attainment of these objectives;
b) afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products in question.

Article 82[205]

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 in so far as it may affect trade between Member States.

Such abuse may, in particular, consist in:

a) directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions;
b) limiting production, markets or technical development to the prejudice of consumers;
c) applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;
d) making the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which,

[205] Treaty Establishing the European Community (Consolidated version in accordance with the Treaty of Nice, OJ 2002 C 325/1-184 (EC).

by their nature or according to commercial usage, have no connection with the subject of such contracts.

Supplement B - U.S. Antitrust Law

§ 1 Sherman Act, 15 U.S.C. § 1[206]

"*Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal. Every person who shall make any contract or engage in any combination or conspiracy hereby declared to be illegal shall be deemed guilty of a felony, and, on conviction thereof, shall be punished by fine not exceeding $100,000,000 if a corporation, or, if any other person, $1,000,000, or by imprisonment not exceeding 10 years, or by both said punishments, in the discretion of the court.*"

§ 2 Sherman Act, 15 U.S.C. § 2[207]

"Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a felony, and, on conviction thereof, shall be punished by fine not exceeding $10,000,000 if a corporation, or, if any other person, $350,000, or by imprisonment not exceeding three years, or by both said punishments, in the discretion of the court."

§ 13a Clayton Act, 15 U.S.C. § 3[208]

"It shall be unlawful for any person engaged in commerce, in the course of such commerce, to be a party to, or assist in, any transaction of sale, or contract to sell, which discriminates to his knowledge against competitors of the purchaser, in that, any discount, rebate, allowance, or advertising service charge is granted to the purchaser over and above any discount, rebate, allowance, or advertising service charge available at the time of such transaction to said competitors in respect of a sale of goods of like grade, quality, and quantity; to sell, or contract to sell, goods in any part of the United States at prices lower than those exacted by said person elsewhere in the United States for the purpose of destroying competition, or eliminating a competitor in such part of the United States; or, to sell, or contract to sell, goods at unreasonably low prices for the purpose of destroying competition or eliminating a competitor."

"Any person violating any of the provisions of this section shall, upon conviction thereof, be fined not more than $5,000 or imprisoned not more than one year, or both."

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[206] http://www.usdoj.gov/atr/foia/divisionmanual/ch2.htm
[207] http://www.usdoj.gov/atr/foia/divisionmanual/ch2.htm
[208] http://www.usdoj.gov/atr/foia/divisionmanual/ch2.htm

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