



eSAPIENCE CENTER FOR COMPETITION POLICY

**CASE NOTE:**

***Microsoft v. EU Commission: Sounds Good In Theory But....***

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**Microsoft v EU Commission: Sounds Good In Theory But....**

By

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**Introduction**

Few cases in the annals of antitrust law have provoked as much reaction and interest as the various Microsoft proceedings, which have now continued in the United States (U.S.), the European Union (EU), and elsewhere for over a decade. Reasons for the inordinate level of interest are fairly obvious. First, Microsoft itself, as a company, has long incited strong opinions and passions. Proceedings outside the U.S. also had the added feature that Microsoft is a company of U.S. origin, prompting trade protection accusations. Second, the affected technology markets are complex, and of obvious major importance to producers and consumers alike, given the ubiquity of personal computers (PCs) and related software. Enforcement agencies continue to struggle to develop clear standards, as well as consistent, useful enforcement action with respect to technology markets. Finally, the principal legal issues in the various Microsoft proceedings—the extent to which a single firm can be compelled to deal with third parties and the limits on its ability to bundle separate products—are arguably the most controversial issues in antitrust law at the moment.

Not surprisingly, therefore, the Court of First Instance (CFI) judgment in the appeal against the 2004 Commission decision fining Microsoft almost €500 million for unlawful refusal to deal and bundling practices was eagerly anticipated. Equally unsurprisingly, however, the CFI ruling will probably do very little to quell the controversies alluded to above. Opinions canvassed on the day of issuance of the ruling—by which time it is hard to believe that anyone could actually have even read and digested its 280 pages—suggested that the ruling “opened the floodgates for a tsunami of lawsuits and stultifying government micromanagement that will significantly hinder the ability of all technology companies to innovate and deliver the most cutting-edge technology available to consumers” and that we are about to enter a “dark period” for technology companies.<sup>1</sup> Supporters of the ruling, in contrast, applauded the decision saying that the CFI had upheld “a landmark commission decision to give consumers more choice in software markets.”<sup>2</sup>

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<sup>1</sup> See *Harsh reaction in US to Microsoft EU antitrust ruling*, Agence France-Presse, available at [http://newsinfo.inquirer.net/breakingnews/infotech/view\\_article.php?article\\_id=89213](http://newsinfo.inquirer.net/breakingnews/infotech/view_article.php?article_id=89213).

<sup>2</sup> See comments by Commissioner responsible for Competition Policy, Ms. Neelie Kroes, attributed in *Global Competition Review*, September 17, 2007.

### Putting Things in Perspective

Before turning to the ruling, it is worth placing some of the above criticisms of the EU proceedings in context. Claims about anti-U.S. bias seem misplaced. The U.S. antitrust agencies took comparable action against Microsoft (albeit in respect of bundling practices in other markets (browsers) and issues such as exclusionary contracts that did not arise in the EU proceedings). Pursuant to the settlement reached by the U.S. agencies with Microsoft, the Microsoft Communications Protocol Program was set up in August 2002. It enables the creation of server software that interoperates with Windows desktop operating systems and other compatible software using Windows communications via a licensing arrangement. In approving the ultimate settlement reached in the US proceedings, the United States Court of Appeals for the D.C. Circuit said that it was a job “[well] done!”<sup>3</sup> Even extreme skeptics of antitrust enforcement such as Robert Bork thought that the U.S. proceedings against Microsoft were entirely appropriate (though he admits to having advised an adverse party in the proceeding).<sup>4</sup>

It so happened that political will at the Federal level, post-settlement, robbed the settlement of much of its force (although certain enforcers at the State level do not appear to have been deterred).<sup>5</sup> But it is hardly much of an argument against the legitimacy of the EU proceedings to say that one U.S. administration thought that enforcement action was essential but a subsequent one was less inclined to implement the remedy in question. So it is not as if the EU proceedings are somehow unprecedented.

Another point that is often overlooked is that the main complainants in the case are in fact U.S. companies, such as RealNetworks (as indeed was the case in the *GE/Honeywell* merger review, where United Technologies was a major complainant).

Claims about a “dark period” for the technology sector also seem overstated. There is no real evidence that the underlying Commission decision in 2004 had any material adverse impact on the technology sector. Clearly, the Commission decision will, when implemented, affect Microsoft, but it is as yet unclear whether that impact will be material and adverse. Moreover, the idea underpinning the various proceedings is that increased interoperability will lead to greater innovation by rivals and so benefit consumers.

U.S. innovation levels remain at record highs and comparatively lower levels of EU innovation are almost certainly bound up in reasons that are much more complex and varied than antitrust law (overall levels of capital investment in the EU and excessive

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<sup>3</sup> *Massachusetts v. Microsoft Corp.*, 373 F.3d 1199, 1210 (D.C. Cir. 2004).

<sup>4</sup> See R Bork in *High Stakes Antitrust: The Last Hurrah* (AEI Brookings Institute, 2003 (ed. R Hahn)), Chapter 3.

<sup>5</sup> Microsoft itself was also said to be slow to implement its obligations under the settlement. See “Microsoft slow to comply with antitrust deal,” ZDNet UK, January 25, 2006, available at <http://news.zdnet.co.uk/itmanagement/0,1000000308,39248913,00.htm>.

labor regulation being perhaps the most obvious ones), as the EU's Lisbon Agenda amply testifies to. Nor is there evidence that the Commission's 2004 decision has provoked lots of lawsuits, in the U.S. or elsewhere. The CFI's ruling confirming the decision cannot realistically be expected to lead to an increase in lawsuits either.<sup>6</sup>

It also bears emphasis that the EU institutions have been extremely cautious in compulsory dealing cases, with actual obligations being imposed in only a handful of unusual/exceptional cases in over 50 years. Indeed, the EU record in respect of refusals to deal is really no worse than U.S. enforcement history. True, the recent U.S. Supreme Court judgment in *Trinko* is widely seen as significantly narrowing the scope of the (already limited) duty to deal under U.S. antitrust law.<sup>7</sup> But *Trinko* leaves many questions unanswered and the precise scope of the duty to deal under US antitrust law remains a major issue in the on-going review of Section 2 of the Sherman Act by the U.S. enforcement agencies.<sup>8</sup> Although it remains to be seen what the outcome of the U.S. agencies' review will be, it seems unlikely that it would go as far as to say that there can never be a duty to deal in the case of a single firm. So in reality, EU and U.S. antitrust laws and enforcement are fairly closely aligned on both the underlying principles and the notion that enforcement is merited in only exceptional cases.

It is also useful to add a word on the procedure adopted in the EU before looking at what the CFI ruling actually says. The Commission proceedings were unusually long and cautious. Several documents containing the preliminary objections against Microsoft were issued, which is pretty unusual in EU competition proceedings. There was also a lengthy oral hearing and the final decision was among the most detailed ever written by the Commission, running to over 300 pages.

Before the CFI, there was an application by Microsoft to suspend the implementation of the Commission's orders (unsuccessful). The hearing itself was among the most extraordinary ever conducted by the CFI, with extremely active case management (normally there is little or none), wide latitude given to Microsoft (and others) to adduce supplemental information not put before the Commission, and an oral hearing that was by far the longest and most extensive in any abuse of dominance appeal, including, for example, technical presentations and other expert testimony. The CFI also sat in a full chamber, which again is virtually unprecedented in an antitrust matter. A number of the sitting judges were also litigators with decades of experience in common law jurisdictions, including in the areas of antitrust law (*e.g.*, Judges Cooke and

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<sup>6</sup> True, the U.S. has experienced an increase in law suits in bundling cases, but these mainly concern price bundling and stem from the 3<sup>rd</sup> Circuit's decision in *Le Page's Inc. v. 3M* (and the refusal by the U.S. Supreme Court to hear an appeal in that case). 324 F.3d 141 (3d Cir. 2003)(en banc), cert. denied 542 U.S. 95 (2004) And, as noted, continued enforcement against Microsoft at a State level in the U.S. cannot reasonably be said to be a function of the EU proceedings.

<sup>7</sup> *Verizon Communications v. Law Offices of Curtis V. Trinko*, 540 U.S. 398 (2004).

<sup>8</sup> The U.S. antitrust agencies concluded on May 8, 2007, their year-long hearings on single-firm conduct. The hearings had 18 days of oral testimony, 28 different panels, and 130 panelists drawn from a range of stakeholders (*e.g.*, lawyers, economists, business people, academics, and business historians). A report on the upshot of the hearings for policy under Section 2 will be published in due course.

Forwood). And the President of the CFI, Judge Vesterdorf, is among the longest-serving and most respected of the Community Courts' judges.

So the whole EU procedure from start to finish seems at least to have been open, fair, and serious. The losing parties may, of course, be aggrieved about certain aspects of the decision-making, or that certain (important) factual issues were overlooked, but it would be hard to conclude from the outside looking in other than that unusually significant attention seems to have been paid to due process.

### **The Refusal to Deal Issues**

To the extent that any duty to deal can ever be described as orthodox, the CFI ruling appears to have followed the long-standing criteria in this regard under EU law. Thus, the test is whether: i) access to the input in question is “essential”; ii) whether the refusal risks the “elimination of competition”; iii) whether the refusal would prevent the emergence of a “new product”; and iv) whether there is “objective justification” for the refusal (see most recently, the *IMS Health* judgment of the Court of Justice,<sup>9</sup> which is binding on the CFI). On each of these points, the CFI assessed a huge amount of evidence, from both sides, before concluding that the conditions were satisfied.

Details of the evidence used in support of each condition lie outside the scope of this relatively short piece. Only a few salient points are noted. On a broad level, it seems that three key conclusions were central to the outcome on the refusal to deal issue:

- ***The unique position of Microsoft.*** A first point—and one, indeed, that underpins the entire ruling—is the extensive reference to the persistent near-monopoly position held by Microsoft in PC operating system software (Windows having over a 90% market share). The ruling talks about Microsoft’s “extraordinary” position as owner of a “de facto standard” in PC operating systems (CFI ruling, paras. 32-33) and the advantages that this position confers on Microsoft products in related markets, independent of the competitive attributes of those products in their own right. The CFI ruling refers at certain points to findings that competitors’ products were equal to or better than those of Microsoft, suggesting, implicitly but clearly, that Microsoft’s near-monopoly position in PC operating systems was being used to gain “artificial” advantage in related markets (see, *e.g.*, CFI ruling, paras. 406 and following). (For example, Microsoft had a market share of over 60% in workgroup servers at the relevant time and around 80% of PCs shipped worldwide had Windows Media Player only pre-installed.)
- ***No source code sharing.*** A second key consideration was that the duty to deal “only” affected interoperability and interconnection information, and not the underlying source code in Windows (CFI Ruling, para. 206). Implicit in this finding is the idea that the interference with property rights was not that

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<sup>9</sup> Case T-184/01, *IMS Health Inc v Commission*, judgment of April 29, 2005.

onerous—the essential function of any intellectual property rights (IPRs) that Microsoft had in its PC operating system software was left more or less intact.<sup>10</sup> Whether in practice this is true, of course, remains to be seen, since the remedies sought by the Commission have yet to be implemented. The CFI's comments on the nature of the information sought seem to echo earlier cases like *Magill* and *IMS Health* where the perceived low creative value of the property rights in question was widely seen as implicit justification for a duty to deal (*in casu* copyright in TV listing information (*Magill*) and a copyright in a map dividing Germany into different territories of pharmaceutical data sales (*IMS Health*)). The notion that “not all property rights are equal” is itself a potential minefield,<sup>11</sup> but the point is that judges are likely to be as influenced by such case atmospherics as anyone.

- ***No cloning by rivals.*** A final major consideration appears to be the finding that the duty to deal would not lead to cloning in the sense that the information would allow non-Microsoft workgroup server operating systems to fully reproduce the functionality of Microsoft's own server operating system (CFI ruling, para 234). The idea is that the extent of interoperability is limited to ensuring an effective interface between rivals' workgroup servers and users' PCs that run on Microsoft's Windows PC operating system (which is around 90% of all PCs). It would seem that the judges were swayed by the idea that the duty on Microsoft was limited to what was proportionate in the circumstances. Again, whether in fact this turns out to be true remains to be seen in the implementation of the remedies, but this was clearly the basic idea the CFI had in mind.

So, as noted, the CFI ruling does not really change the existing EU law on refusal to deal in any material respect and, in assessing the application of the existing legal rules, appears to have undertaken a level of factual review that was very detailed and reasonably balanced (though, as noted, it is hard for an outsider not having access to the underlying evidence to second-guess the quality of evidential review). To that extent, it is hard to criticize the ruling in so far as it goes.

But there are more profound points that underpin the judgment that do not appear to have been particularly well thought out, either by the Commission or the CFI. Whether these issues are for a court of law to decide or should more appropriately be addressed by policy makers can be debated, but the issues cannot really be avoided in any intelligent application of a duty to deal.

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<sup>10</sup> A key part of the ruling in this regard is the limited review undertaken by the CFI to test whether workgroup server vendors needed the degree of interoperability sought by the Commission in order to remain viable on the market. Here, the CFI took refuge in its limited judicial review function on matters of complex assessment (CFI ruling, para. 379) – essentially recycling the same evidence as the Commission did. While understandable perhaps, it inevitably ducks to some degree a very important issue.

<sup>11</sup> See R. O'Donoghue & A.J. Padilla, *The law and economics of Article 82 EC*, Hart Publishing, 2006, pp.462-463 (identifying the problems with this approach as a potential justification for a duty to deal).



A first issue is that, at no point, does the CFI ruling really put into perspective just how extraordinary any duty to deal is (or should be). Although the CFI ruling at times emphasizes the extremely strong position held by Microsoft in PC operating systems, and the ways in which that distorted competition in related markets, the far more important corollary of this—that the conditions for a duty to deal will only ever be met in the very rarest of circumstances—goes virtually unmentioned.

This point *sounds* semantic, but it is not. Virtually all of the criticisms of a duty to deal quite rightly worry about the effect that the sharing of key assets would have on property rights and innovation incentives. EU law, as it stands, does not say that a duty to deal can never be justified (and nor for that matter does US antitrust law, even post-*Trinko*). So it is vitally important that all of the obvious reasons why firms do not have to deal against their will are given prominence, since, in so doing, it becomes very clear that the duty to deal in practice plays a very residual role. The only real attempt to do this at EU level has been an opinion by Advocate General Jacobs in the *Bronner* case almost a decade ago. It was surely appropriate for the CFI to amplify the vital underlying general objections to a duty to deal in its ruling. Not doing so risks “normalizing” the duty to deal, which would be wholly inappropriate as a matter of general policy.

This was effectively what the U.S. Supreme Court did in *Trinko* and it is right and appropriate that general skepticism about a duty to deal under antitrust law should be expressed too, in very clear terms, in the EU, even if they are not minded to go as far as *Trinko* does in this regard. Thus, in the same way that the *Trinko* judgment treats the Supreme Court’s earlier decision in *Aspen Skiing* as representing the outer limit of the duty to deal under U.S. antitrust law, so too the CFI in *Microsoft* should have made very clear that the intervention, and not merely Microsoft’s market share, was “extraordinary.” This cannot be emphasized often enough. And it is particularly important in the current climate where the Commission is reconsidering its policy in relation to abuse of dominance cases. The Community Courts cannot simply decide cases in such an environment. They must provide clear guidance on important questions of policy and policy emphasis.

A further related point is the pretty superficial treatment given by the CFI to the issue of “objective justification” in refusal to deal cases. The CFI noted that the mere fact that a duty to deal involves intellectual property rights is not a defense (CFI ruling, paras. 690-691) and that Microsoft’s arguments about the impact on innovation incentives were “general, vague, and theoretical” (para. 698). Citing a key passage from the Commission decision, the CFI reiterated that “the need to protect Microsoft’s incentives to innovate cannot constitute an objective justification that would offset the exceptional circumstances identified” (CFI ruling, para. 707).

The tenor of this statement is very troubling, even if there may have been some basis for reaching this conclusion in the case of the disclosure obligations sought against Microsoft. The fundamental objection to any duty to deal is that it is precisely those assets that are most valuable that will be “indispensable” for rivals and “eliminate

competition” and so justify a duty to deal. Indeed, in the case of IPRs at least, a duty to deal is fundamentally inconsistent with the exclusivity granted to their owner for a limited period. This period of exclusivity is intended to provide a return on investment and so stimulate *ex ante* innovation incentives.

As EU law currently stands, this exclusivity does not have the effect of immunizing IPRs from a duty to deal. Indeed, it seems circular, to some extent, to argue that a duty to deal is appropriate because an input is indispensable for competition, and then to allow a defense based on the fact that the dominant firm has developed a valuable asset through investment. The defense could be invoked precisely in those circumstances in which the adverse effects of a refusal to deal on competition were most likely to be serious.

But there is undoubtedly a problem with the current legal conditions for a duty to deal in that they place undue emphasis on the static, or short-term, effects of the refusal to deal on competition. There is no meaningful analysis of the long-term effects of a duty to deal on innovation and investment, *i.e.*, dynamic competition. Many valuable IPRs for example will, if they are valuable enough, attract large rewards for their owners and exclude competition by rival firms. This is central to the reason why such rights are granted in the first place. Once an extremely valuable asset has been created, and so allows a firm to achieve a near-monopoly position, the benefits of sharing it will always look attractive *ex post*. However, it is precisely this prospect of large future profits that spurs risky decision-making *ex ante*.

Thus, it cannot be right, in general, to say that every IPR that is “indispensable” for rivals and would “eliminate competition” should be shared. If that were the law, those assets that were most valuable would, perversely, be the most likely to warrant compulsory sharing. True, EU law does have the additional condition that the rivals should seek to bring some added innovations or new product to market, *i.e.*, products not offered by the dominant firm. But it will probably be relatively easy to show this in most cases: the CFI now seems to suggest that product differentiation is enough (CFI ruling, para. 656).<sup>12</sup>

There needs therefore to be a greater limiting principle. The “objective justification” plays this vital role. Mere satisfaction of the basic criteria for a duty to deal cannot be sufficient justification for access to be ordered—the dominant firm must still be entitled to refuse to deal because its property represents the result of significant

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<sup>12</sup> As noted, the ruling does appear to dilute the “new product” requirement in favor of a test based on mere product differentiation or evidence that there is a “limitation of technical development” (CFI ruling, para. 647). This merits a few comments. First, it was already arguable from earlier case law that the “*new product*” requirement was not an exhaustive definition of “exceptional circumstances” in refusal to deal cases involving IPRs under EU law. *See generally*, R. O’Donoghue & A.J. Padilla, *The law and economics of Article 82 EC*, Hart Publishing, 2006, Ch. 8. Second, the CFI cannot really be criticized for using the phrase “limitation of technical development.” This phrase comes directly from the wording of Article 82(b) itself. Finally, there was evidence that rivals’ products were superior to Microsoft’s, in particular in the early stages of the infringement. But the case does broaden the law somewhat since it now seems that a duty to deal can concern directly competing (if somewhat differentiated) products to those already offered by the dominant firm.



investment or original work. It must be a defense in most circumstances to show that the requested input is the result of significant research and development, or is extremely valuable for some other reason.

This issue was alluded to in the Commission's 2005 draft paper on abuse of dominance,<sup>13</sup> but is not really addressed at all by the CFI. Merely stating that the valuable nature of the IPR in question may be a defense in a duty to deal case would probably have gone a long way towards deflecting some of the criticism of the CFI's ruling.<sup>14</sup>

There is probably no reliable way, in practice, that an antitrust authority or court can (or arguably should) balance *ex post* the benefits of a duty to deal against its adverse effects on *ex ante* incentives for innovation and investment. Using the words of the CFI, arguments of this kind will by nature always be "general, vague, and theoretical." But they are no less valid for this. Second-best solutions can be used though. For example, there are industries in which empirical evidence shows that the principal parameter of competition is research and development. An obvious case concerns the pharmaceutical industry where valuable patents may allow firms to achieve large net profits. Large profits are necessary, however, to fund research efforts on other potential products—most of which never lead to commercial products.<sup>15</sup> In these circumstances, it can be seriously questioned whether a general duty to share essential IPRs—even when limited to the development of new kinds of products—is appropriate as a matter of public policy. These considerations are by no means unique to the pharmaceutical sector, but would equally apply to any other industry or product where empirical evidence, experience, or logic suggests that general duties to share valuable assets would discourage more competition than they created. Some basic recognition by the CFI of this fundamental point was essential.

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<sup>13</sup> See also DG Competition discussion paper on the application of Article 82 of the Treaty to exclusionary abuses, Brussels, December 2005, para. 235 ("The risks facing the parties and the sunk investment that must be committed may thus mean that a dominant firm should be allowed to exclude others for a certain period of time in order to ensure an adequate return on such investment, even when this entails eliminating effective competition during this period.").

<sup>14</sup> At least one national competition authority in the EU has rightly accepted this defense. In *DuPont Holographic System*, the Office of Fair Trading noted that DuPont's holographic film product was the result of original research and development and that the mere fact that it had certain unique advantages over rival products at the time was not a reason in itself to compel a duty to deal. See Case CP/1761/02, *E.I. du Pont de Nemours & Company and Op. Graphics (Holography) Limited*, Decision of the Office of Fair Trading on September 9, 2003, para. 29:

Unprocessed HPF is the product of research and development by DuPont. The effect of treating every new product which, at the time of its discovery, had unique properties as an essential facility (if this product was a necessary input into a downstream market), would be to permit an excessive degree of interference with the freedom of undertakings to choose their own trading partners. As stated above, competition law should have this effect only in exceptional circumstances.

<sup>15</sup> Apparently, only one in approximately every 435 drugs that are considered ever makes it to the market. See H Grabowski, "Patents, Innovation and Access to New Pharmaceuticals," mimeo, Duke University, July 2002. See also J.A. Dimasi, "Research and Development Costs For New Drugs by Therapeutic Category," (1995) 7 *Pharmacoeconomics* 152–169.

A final point about the CFI's findings on refusal to deal sounds rather technical, but actually could be tremendously important in practice. The CFI found that there is no requirement in a duty to deal case that the input to which access is sought is marketed separately:

it was sufficient that a potential market or even a hypothetical market could be identified and that such was the case where the products or services were indispensable to the conduct of a particular business activity and where there was an actual demand for them on the part of undertakings which sought to carry on that business. (CFI ruling, para. 335).

This issue may not have been so troubling in *Microsoft*, since Microsoft had, at one time, supplied interoperability information to rivals, thus suggesting that there was a "market" for such information. Disclosure of interoperability information was also common in the industry. But the CFI's formulation, that an essential "input" can be anything that is of potential or hypothetical use to rivals, is far too broad, and potentially dangerous. A production chain cannot be divided into a series of severable stages at the request of any competitor who wishes to have access to key competitive advantages. To do so would risk atomizing IPRs that are used only as inputs—often critical ones—in products or services that are commercialized successfully. As one commentator has noted, under this standard "any intellectual property right could 'hypothetically' be marketed as a stand-alone item," and hence potentially subject to an obligation to license, which would "create a huge disincentive for dominant firms to invest in new production processes that would allow them to gain a competitive advantage vis-à-vis competitors."<sup>16</sup> There is accordingly some pragmatic appeal to the suggestion made by the U.S. Supreme Court in *Trinko* that a duty to deal might best be considered only where there is a prior course of dealing. At least, in that instance, it is reasonably clear that there is a "market" in some relevant sense.

### **The Bundling Practices**

The CFI's analysis of the bundling of Microsoft's Windows Media Player (WMP) with its Windows PC operating system is also reasonably orthodox. The CFI applies a rule of reason-type legal test and undertakes a detailed factual review of the application of those conditions to the practice at issue.

The legal conditions applied by the CFI are as follows: i) the tying and tied products are two separate products; ii) the undertaking concerned is dominant in the market for the tying product; iii) the undertaking concerned does not give customers a choice to obtain the tying product without the tied product; iv) the practice in question forecloses competition; and v) absence of objective justification (CFI ruling, para. 842).

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<sup>16</sup> See D. Geradin, "Limiting the Scope of Article 82 EC: What Can The EU Learn From the US Supreme Court's Judgment in *Trinko*, in the Wake of *Microsoft*, *IMS*, and *Deutsche Telekom*?" (2004) 41 *Common Market Law Review* 1519, 1530.

These conditions are similar to those set out by the Community Courts in the assessment of non-horizontal mergers involving foreclosure effects through bundling practices. They are also similar to those used by the District Court in the U.S. Microsoft proceedings, although somewhat different from those endorsed by the U.S. Court of Appeals in the same matter.<sup>17</sup>

The CFI's factual review also seems to have been very forensic. Again, some "big picture" points underpin the CFI's thinking. Most notably, the enormous advantage afforded by Microsoft's near-monopoly in PC operating systems was of decisive importance, since the CFI found that it allowed Microsoft to effectively dictate PC OEMs' choices (CFI ruling, para. 1054). A related point is the suggestion in the ruling that Microsoft was able to reduce the quality of the package (Windows/WMP) compared to what OEMs were increasingly choosing (Windows/RealPlayer) (CFI ruling, para. 1057).

As often happens in these sorts of cases, internal emails also played an important role. The CFI cites internal Microsoft emails recognizing the quality shortfall and the objective of the tie—at least initially—being to gain a Windows platform monopoly maintenance advantage (CFI ruling, para 911). So the implicit suggestion is that consumers did not benefit from the tie compared to what the package could have been.

Unfortunately, some of these findings are interspersed with unhelpful phrases such as "Microsoft impaired the effective competitive structure on the work group server operating systems market by acquiring a significant market share on that market." (CFI ruling, para. 664). But these points should be seen in context and should not detract from the extensive review undertaken by the CFI overall.

So, like the refusal to deal case, the CFI ruling is hard to criticize in so far as it goes. But it also appears that the CFI was more concerned with deciding the case on the tying issue than trying to understand the policy and practical implications of its ruling. Again, the CFI ruling can be criticized for a lack of perspective on tying and bundling practices. There is lots of evidence that tying can produce significant consumer benefits and that these benefits apply *a fortiori* in the case of technical integration of products.<sup>18</sup> There is also widespread agreement that theories of anticompetitive harm in tying cases only apply in certain limited factual settings (*e.g.*, monopoly maintenance). These basic points are nowhere given any real prominence in the ruling. By implication, of course, the CFI's reference to the position and conduct of Microsoft suggests that this was an exceptional case, but, again, it would have made a lot of sense for the CFI to say much more about the more basic point, *i.e.*, that tying, even by dominant firms, is often pro-competitive. This is not a matter of semantics but goes to the heart of the overall policy direction in tying cases.

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<sup>17</sup> See *United States v. Microsoft Corp.*, 253 F.3d 34, 84 *et seq.* (D.C. Cir. 2001).

<sup>18</sup> See R. O'Donoghue & A.J. Padilla, *The law and economics of Article 82 EC*, Hart Publishing, 2006, pp.480-483.

A second major problem is that it is hard to see how any remedy can really be effective in the present case. The present idea is that Microsoft can continue to bundle WMP with Windows but must also make an unbundled version available for purchase. When the issue was raised before the Commission, Microsoft apparently decided to charge the same price for the unbundled Windows and a Windows/WMP bundle. Not surprisingly, this makes it hard to see why OEMs and consumers would choose an unbundled version (which was apparently what happened when the test versions were released following the Commission decision). However, the Commission's decision does not explicitly deal with the pricing of unbundled Windows. In particular, it does not state whether Microsoft may price unbundled Windows at the same price as a Windows/WMP bundle. The decision does state that Microsoft may not adopt measures that have an equivalent effect to the tie (see also CFI Ruling, para. 908). Complainants may argue that charging the same price for the unbundled Windows and the Windows/WMP bundle perpetuates the tie, since it leaves customers with no commercial realistic reason not to take the bundle. All of this will require careful resolution by the Commission. But it seems somewhat odd that the remedy in a tying case concerning technical integration will be largely about setting and monitoring the prices that Microsoft charges for its products.

The above issue is to some extent subsidiary in that it will be resolved one way or the other by the Commission. But a much more troubling wider issue raised by the CFI ruling is how Microsoft, or any other firm in a potentially similar position, is supposed to comply with the principles set out in the ruling on tying. Where the tying allegation concerns technical integration of software functionality, it is fundamentally unclear at what point two software products can be said to be separate (assuming the tie is not a pure sham). It seems obvious that the techniques used by the CFI to test for separate products—whether there is consumer demand for the unbundled version—are, in general, not capable of *ex ante* application by a dominant firm at the time it decides to make the technical integration. As the U.S. Court of Appeals noted in rejecting the *per se* approach to tying in Microsoft:

The direct consumer demand test focuses on historic consumer behavior, likely before integration, and the indirect industry custom test looks at firms that, unlike the defendant, may not have integrated the tying and tied goods. Both tests compare incomparables – the defendant's decision to bundle in the presence of integration, on the one hand, and consumer and competitor calculations in its absence, on the other.<sup>19</sup>

The same reasoning applies to the foreclosure condition set out by the CFI. New technical integration of two or more software functions can only really give rise to foreclosure over time (if at all). There is no way, *ex ante*, that a dominant firm can know this, and there is no precise point thereafter at which it would become very clear that it should then start to offer unbundled versions of the products in parallel with bundled versions so as to avoid antitrust liability.

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<sup>19</sup> See *United States v. Microsoft Corp.*, 253 F.3d at 84, *et seq.*

On top of all this, what about consumer benefit? In all cases but a sham tie, consumers benefit from technical integration. A cautious (dominant) firm may well decide, therefore, *ex ante* that the rules on technical integration are so unclear and risky that it will not integrate functions that it would have done otherwise. Consumers clearly lose in this situation. Even if the firm decides to run the risk, there is no way, *ex ante*, under the test laid down by the CFI, that the integrator can weigh, under the objective justification heading, the benefits of integration to consumers against foreclosure of rivals. In particular, if the tied product is better in quality than stand-alone rival offerings, to what extent does the dominant firm still have to assist rivals by offering an unbundled product? These kinds of decisions can only be made, if at all, *ex post*, and, even then, they are enormously complicated, as the CFI's ruling amply shows.

In effect, therefore, once bitten, the dominant firm runs the real risk of being exposed to a repeat game in respect of all of its future integration on a dominant platform (which seems to be what's happening with new releases of Microsoft's Windows products). What will the antitrust agencies tell the lawyers? What are the lawyers supposed to tell the company engineers? What are the engineers supposed to do? All of this seems fundamentally at odds with any notion of a proper rule of law.

Finally, the CFI's treatment of network effects seems skewed in that it only relies on such effects as negative evidence to show, *e.g.*, Microsoft's dominance or the (anti-competitive) motivation for its practices. But this issue should have been more carefully thought through to a more logical conclusion. The EU proceedings do not criticize the way in which Microsoft became dominant in PC operating systems. (What the Commission and CFI seemed to object to were the unlawful efforts to maintain that monopoly through conduct in other markets). Standardization around a dominant operating system normally creates enormous benefits for consumers, including greater availability of software written on the standard (which would not be developed at all in a fragmented market).

The same reasoning applies to streaming media players. If, as the CFI found, there are network effects, the market will optimally converge around a leading standard in any event. But the CFI uses the existence of indirect network effects only as an argument supporting foreclosure effects in the case of tying (CFI ruling, para. 1061). No real consideration is given to the obvious conclusion, *i.e.* that consumers would converge around a dominant standard in any event, because it benefits them to do so. All things equal, whether that dominant standard was a Microsoft product or another one should not matter to consumers. Put simply, if there are indeed network effects, foreclosure is inevitable, but consumers benefit. This basic point is not satisfactorily addressed in the ruling.

### **Conclusion**

The CFI ruling in *Microsoft* is undoubtedly seminal and will be studied in great detail for years to come. Short of annulling the Commission decision on every point,

there were always going to be critics of the judgment. But most of these are of the view that antitrust law should never ever order a duty to deal, that all technical integration should be *per se* legal, and that IPRs should be immune from antitrust scrutiny—a series of positions that do not represent the current law in either the EU or the U.S. The same critics often gloss over what the EU authorities have actually said in the key decisions and judgments and ignore the unprecedented care and attention devoted to the case.

But the CFI ruling comes at a critical juncture in the reform of EU policy on abuse of dominance. Against this backdrop, the ruling does not really clarify either the law or the policy to any great extent. The CFI for example seems to have missed a vital opportunity to state authoritatively just how exceptional findings of compulsory dealing and unlawful tying are. Not doing so risks “normalizing” the treatment of such practices as suspicious under antitrust law, providing fodder for critics. In particular, it cannot be right, in general, that there is a duty to deal simply because an input is “essential” for new rival innovation and competition would be “eliminated” by the refusal to deal. A general proposition to this effect short-circuits the competitive process. More needs to be said about limiting principles.

Similarly, on tying, the basic economic consensus—that tying is often good and is only bad under certain restrictive assumptions—is found nowhere in the ruling (even if the case at hand may well have been one of those exceptions). Nothing either is said in terms of the positive implications of network effects for the analysis; these are only used as negative points against Microsoft, with no real reference to the more important point that those effects typically benefit consumers.

Finally, regarding the tying abuse itself, the ruling seems fine, in so far as it goes. But it seems to me that the test, as applied in the ruling, is virtually impossible for a firm to apply *ex ante* at the time it is considering whether to deepen technical integration. If correct, this is a fundamental flaw. The case almost certainly therefore confirms the old legal saw that “hard cases make bad law.”