

## Commission adopts Decision in the Microsoft case

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### 1. Introduction

On March 24 2004, the Commission concluded its Microsoft investigation by way of a formal Decision. This brought to an end proceedings which had lasted just over five years. The Commission found that Microsoft had abused its dominant position in PC operating systems by (i) refusing to provide interoperability information necessary for competitors to be able to effectively compete in the work group server operating system market; and (ii) tying its Windows Media Player with Windows.

### 2. Procedure

The case originated with a complaint in December 1998 from Sun Microsystems, which alleged that Microsoft, with its Windows product, enjoyed a dominant position in PC operating systems, and that it had abused this dominant position by reserving to itself information that certain software products for network computing, called work group server operating systems, needed to interoperate fully with Windows. Following an investigation into this complaint, the Commission issued a Statement of Objections on 1 August 2000 which focussed on the interoperability issues in Sun's complaint.

In parallel, in February 2000, the Commission had launched an *ex officio* investigation into Microsoft's Windows 2000 generation of PC and server products, as well as Microsoft's incorporation of Windows Media Player into its PC operating system product. On 30 August 2001, the two procedures were joined with the sending of a second Statement of Objections to Microsoft. On 6 August 2003, following an extensive market enquiry, the Commission issued a third Statement of Objections, focussing on both issues of interoperability and tying. An Oral Hearing was held on 12-14 November 2003.

### 3. Microsoft's dominance

The common point of departure for both of Microsoft's abuses was its overwhelmingly dominant position in PC operating systems, the soft-

ware that runs PCs. Microsoft's current market share in this market, with its Windows product, is between 90 and 95%, and it has enjoyed the same high market shares for many years. In its response to the third Statement of Objections, Microsoft recognised its dominance in this market.

The Decision highlighted that the key to Microsoft's enduring dominance were the network effects relating to the applications that run on Windows. Applications that are written to Windows will not run on other operating systems. The main benefits that consumers derive from a given PC operating system relate to the number and variety of applications that they can run on it. Similarly, software developers who write applications value operating system platforms that enable them to reach the greatest number of users. There is therefore a self-reinforcing dynamic, because the higher the number of users of a given operating system platform, the greater the number of applications that applications developers write for that platform and *vice versa*.

Due to the ubiquity that Microsoft has achieved on the PC operating system market, virtually all commercial applications are written first and foremost to the Windows platform. There is therefore a very strong network effect which protects Microsoft's position. This is called the '*applications barrier to entry*'.

### 4. Microsoft's abuses

#### 4.1. Interoperability

The Decision identifies a relevant market for work group server operating systems. These are operating systems which are designed and marketed to deliver collectively to PC users the core tasks of file and print sharing and group and user administration within a corporate/administrative network. As such, interoperability with PCs is a necessary attribute of these products. The Commission also found that these operating systems are generally installed on cheaper servers.

As regards demand side substitutability, these operating systems fulfil a different demand to

other operating systems such as: (i) higher-level operating systems, which support mission/business-critical applications; or (ii) 'edge' server operating systems, such as firewall or web server operating systems. As regards supply side substitutability, although different server operating systems within a given product range are generally built on a common 'code base', each server operating system within this product range needs to be optimised according to the tasks that it is designed to fulfil, and this requires a specific development and testing process. This process involves significant time and costs. Supply side substitutability from other markets does not therefore represent an appreciable competitive constraint in the market for work group server operating systems. The Decision also identifies significant barriers to entry in the work group server operating system market, in particular due to the presence of network effects in that market.

Sun supplied evidence that it had requested technical information on how Windows work group servers interoperate with Windows PCs in order to adapt its own work group server operating system offering to compete with Microsoft's, and that it had not been provided that information. Microsoft acknowledged during the course of the investigation that it was not prepared to provide the information requested by Sun to Sun or any other work group server operating system vendor. Indeed, many work group server operating system vendors confirmed to the Commission that they had difficulties in building products compatible with the architecture of Windows work group networks (PCs + work group servers). The Commission therefore concluded that Microsoft had engaged in a general pattern of conduct of withholding interoperability information from its competitors. The Commission also identified that similar information had been previously provided to the industry at large — through disclosure to AT&T — and that with Windows 2000, Microsoft disrupted this previous level of supply.

It must be underlined that the information at issue consists of the rules of connection between software elements in an IT network. The legally relevant refusal is not a refusal to supply the Windows source code, which constitutes the core of Microsoft's products. Microsoft is able to document the information at issue in the form of interface specifications and thereby supply this information without having to disclose source code.

It is also noteworthy that the relevant information relates to the organisation of Windows work group networks, which is based on an architecture of interrelated PC-to-server and server-to-server

connections: for full interoperability with the PC to be achieved in this context, server-to-server connections are indispensable. As a result, the refusal, although it involves both client-to-server and server-to-server connections that relate to the interoperation within Windows work group networks, is in its essence a denial of compatibility with Windows PCs to competing work group server operating systems.

Although undertakings are as a rule free to choose their business partners, it is established case-law that a refusal to supply may in certain circumstances constitute an abuse of a dominant position, unless it is objectively justified. In the present case, the Commission has identified the following exceptional circumstances of Microsoft's refusal.

First and foremost, Microsoft's refusal risks eliminating competition in the work group server operating system market. This is borne out by the evolution of Microsoft's market power in that market, where the Decision establishes that Microsoft has actually already attained a dominant position and that its market shares continue to grow. The Commission collected a very significant amount of customer evidence showing that it is the 'interoperability advantage' that Microsoft reserves to its product *via* its refusal to supply interoperability information that drives customers towards Microsoft's work group server operating system products. This is confirmed by customer data provided by Microsoft itself. The Decision establishes that the interoperability information is indispensable to be able to viably compete in the work group server operating system market. In particular, the Commission extensively analysed actual and potential substitutes to the interoperability information which Microsoft had argued were effective, and concluded that they were technically or commercially unrealistic. It is also noteworthy that, due to the presence of significant barriers to entry in the work group server operating system market, an elimination of competition would be difficult to reverse.

Second, Microsoft's refusal limits technical development in the impacted market to the prejudice of consumers. If competitors had access to the refused interoperability information, they would be able to provide new and enhanced products to the consumer. Market evidence shows that consumers value product characteristics such as security and reliability, although those characteristics are relegated to a secondary position due to Microsoft's interoperability advantage. Microsoft's refusal thereby indirectly harms consumers.

Microsoft's justification was that the information at stake was protected by intellectual property rights. The Commission did not take a position on the validity of Microsoft's general intellectual property claims, which could in any case only be ascertained on a case by case basis when Microsoft has prepared the relevant specifications.

An undertaking's interest in exercising its intellectual property rights cannot as such constitute an objective justification when exceptional circumstances such as the ones identified above are established. However, the Commission did not *limine* reject Microsoft's proffered justification, and addressed the impact on Microsoft's incentives to innovate of an obligation to supply in this case. First, the Commission concluded that an order to supply the relevant information could not lead to the cloning of Microsoft's product, not least because the interoperability information relates to interface specifications as opposed to source code. Second, the Commission took account of the fact that disclosure of interoperability information was commonplace in the industry. Third, the Commission drew inspiration from the *IBM* undertaking and from the 1991 Software Directive,<sup>(1)</sup> which strikes a balance between interoperability and copyright in restricting in specific circumstances the exercise of copyright over software (including exercise by non-dominant undertakings) in favour of interoperability, thereby stressing the importance of interoperability in the software industry in order to enhance competition and innovation.

In view of those exceptional circumstances, the Commission concluded that Microsoft's behaviour amounted to an abuse of a dominant position.

#### 4.2. Tying

The Decision expounds that tying prohibited under Article 82 of the Treaty requires the presence of the following elements: (i) the undertaking concerned is dominant in the tying product market; (ii) the tying and tied goods are two separate products; (iii) the undertaking concerned affords consumers no choice to source the tying product without the tied product; and (iv) tying forecloses competition. In addition, it needs to be examined whether there is any objective justification for the tying.

The Commission concluded that PC operating systems and media players are separate products. This is because: (i) although Microsoft has been tying its media player with Windows for some

time, there remains today separate consumer demand for stand-alone media players, distinguishable from demand for PC operating systems; (ii) a number of vendors develop and supply media players on a stand-alone basis; and (iii) Microsoft itself develops and distributes versions of its Windows Media Player for other PC operating systems.

The Commission also concluded that Microsoft afforded consumers no choice to obtain Windows without Windows Media Player; Windows Media Player is always present on a Windows PC. Even though the icon can be hidden, the product itself cannot be removed and the code remains instantly accessible on a user's PC (this is important for the subsequent harm to competition analysis). The issue of whether or not consumers are obliged to use Windows Media Player with Windows was different to the question of whether they are obliged to obtain Windows Media Player with Windows. The question of usage of Windows Media Player as opposed to other media players was nevertheless of key importance when the Commission considered the issue of whether tying harmed competition.

On this point, the Commission took into account the fact that users can and do also obtain other media players (mainly over the Internet) and that these media players are often free. The Commission therefore undertook a detailed analysis of the impact of Microsoft's behaviour, which included extensive questionnaires to a range of content providers, software developers and content owners.

The Decision outlined that the tying of Windows Media Player to Windows afforded Microsoft unmatched ubiquity on PCs worldwide, because Windows Media Player instantly shares the ubiquity of Windows in newly-shipped PCs. The Commission's analysis of the relevant evidence highlighted that other distribution means (e.g. downloading over the Internet, bundling with other software or hardware, agreements with OEMs and the retail channel) are second best. This guarantees content providers and software developers that if they use Microsoft's technology, they will be able to reach almost all PC users worldwide. Furthermore, the Commission's market enquiry showed that supporting several technologies generates significant additional costs. As such, Windows Media Player's ubiquitous presence induces content providers and software developers to rely on Windows Media technology.

(1) Council Directive 91/250/EEC of 14 May 1991 on the legal protection of computer programs.

Due to the fact that applications and content are largely specific to the proprietary infrastructure used, customers will in turn prefer using Windows Media Player, since a wider array of complementary software and content will be available for that product.

This self-reinforcing mechanism seriously undermines the competitive process in the media player market to the detriment of innovation and the consumer, and has spill-over effects on competition in other markets. For instance, it strengthens Microsoft's position on media encoding and management software (often server-side). If Microsoft came to control the media player market, then its proprietary technology could constitute a significant barrier to market entry, not only to the media player market but also to related markets in which streaming media technologies are used (e.g. handheld devices).

The Commission's analysis was supported by market data, as well as by surveys commissioned by Microsoft itself. These figures showed a clear trend in favour of usage of Windows Media Player and Windows Media formats, to the detriment of competitors. Microsoft's argument that its success was the result of competition on the merits was not supported by the available evidence, which did not indicate a clear-cut lead of Windows Media Player in terms of product quality.

Microsoft attempted to objectively justify its conduct by putting forward a number of efficiency considerations related to distribution, and to the protection of the coherence of Windows, which according to Microsoft, outweighed any anti-competitive effects from tying. The Commission concluded that any such efficiencies could be achieved without resorting to tying. As for Microsoft's argument that tying Windows Media Player would be efficient as it provided a focal point for developers of complementary and compatible content and software, this is not a legitimate argument under Community competition law as it distorts competition on the merits.

In light of the above, the Commission concluded that Microsoft's tying of Windows Media Player with Windows violated Article 82, and in particular paragraph (d).

## 5. Remedies and fines

### 5.1. Interoperability

The Decision orders Microsoft to disclose the information that it has refused to supply and allow

its use for the development of compatible products. The disclosure order is limited to interface specifications (not source code), and to ensuring interoperability with the essential features that define a typical work group network. It applies not only to Sun but to any undertaking that has an interest in developing products that constitute a competitive constraint to Microsoft's product in the work group server operating system market.

The conditions under which Microsoft makes these disclosures must be reasonable and non-discriminatory. Microsoft is allowed to require a reasonable and non-discriminatory remuneration for the production of the documentation, as well as for specific intellectual property rights that the Decision might prevent it from fully enforcing against beneficiaries of the order to supply (provided that Microsoft can establish that these specific intellectual property rights are valid in the European Economic Area).

### 5.2. Tying

The Decision orders Microsoft to provide a version of Windows which does not include Windows Media Player. PC manufacturers and consumers are thus left the choice to obtain Windows with the media player of their — not Microsoft's — choice. To maintain competitive markets so that innovations succeed or fail on the merits is an important objective of this remedy order. This will be beneficial to consumers. It is important to note that consumers have the benefit of PC manufacturers acting as their "purchasing agents" in relation to media player vendors. Consumers will not be forced to do that job themselves by rummaging through the web.

It is worth noting that the Commission does not prevent Microsoft from also offering a bundled version of Windows including Windows Media Player. However, the Decision makes clear that Microsoft must not circumvent the decision by engaging in technical or economic tying.

### 5.3. Monitoring regime

In order to enable the Commission to efficiently oversee Microsoft's compliance with the Decision, a monitoring regime is foreseen by the Decision. Microsoft is required to submit a proposal to that effect, including provisions for the establishment of a monitoring trustee. The Decision outlines what the Commission considers to be the necessary tasks that the trustee should be able to carry out. In essence, these are tasks that will assist the

Commission in enforcing the decision on an ongoing basis, and in the face of Microsoft's products developing and changing.

As regards interoperability, the monitoring trustee's responsibility should, in particular, involve assessing whether the information made available by Microsoft is complete and accurate, whether the terms under which Microsoft makes the specifications available and allows their use are reasonable and non-discriminatory, and whether the ongoing disclosures are made in a timely manner.

As regards tying, the trustee's responsibility should, in particular, be to advise the Commission whether substantiated complaints by third parties about Microsoft's compliance with the Decision are well-founded from a technical point of view.

#### 5.4. *Fines*

In view of the above abuses, the Commission imposed a fine of € 497.196 million. The fine represents 1.62% of Microsoft's annual worldwide turnover. <sup>(1)</sup> Microsoft's infringement was considered very serious on the basis of the nature of the infringement, its impact on the market, and the size of the relevant geographic market. The initial starting amount of the fine was set at € 165.732 million. In view of Microsoft's size and resources, in order to ensure a sufficient deterrent effect, this was multiplied by a factor of 2. The starting amount was therefore € 331.464 million. This amount was increased by 50% in order to take into account the 5 years and 5 months duration of the infringement. In view of the absence of both aggravating and attenuating factors, the final amount of the fine was therefore at € 497.196 million.

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<sup>(1)</sup> EUR € 30,700.336 million.