The Commission's *Microsoft* Tying Case: Implications for Innovation Throughout the High-Technology Sector

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The ability to innovate in high technology products through the improvement of existing features or the incorporation of new features demanded by consumers is a key engine of economic progress. This is demonstrated by the existence of many innovative products in the marketplace, ranging from Apple's latest iPhone to the latest aircraft which include a wide array of new and ever improving features. It is therefore not surprising that Microsoft considers that it must keep up with consumer demand and competitive alternatives from Apple, Linux and others by continually adding new and better features. These include those necessary to enable the entertainment and communications functionality that consumers expect from computers today.

Of course, Microsoft recognises that competition law can place limits on how companies design their products, and is very aware of its "special responsibility" under Article 82 EC as the dominant supplier of PC operating systems. Therefore, Microsoft has developed Windows in a way that preserves opportunities for third parties while ensuring the best user experience for consumers. However, as this paper explains, the theories applied by the European Commission (the "Commission") against Microsoft are unsupported factually and legally. Instead of carrying out a thorough and proper analysis of the issues, it appears that the Commission gave undue weight to the self-interested claims of one third party media player vendor. The Commission's continuing attempts to defend its theories should be of serious concern to any company innovating in high-technology products who wish to improve existing features or add new features to successive versions of its products on a uniform basis.

I. The *Microsoft* Decision

On 24 March 2004, the Commission adopted a decision against Microsoft in Case No COMP/C-3/37.792 – Microsoft (the "Decision"). This Decision concluded that Microsoft committed two infringements of Article 82 EC and Article 54 of the EEA Agreement (hereafter collectively "Article 82 EC"), namely by (i) allegedly refusing to supply so-called "Interoperability Information" and (ii) allegedly tying "Windows Media Player" with its client PC operating systems. This paper focuses on the latter of the two infringements identified in the Decision. Both are the subject of an

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appeal in Case T-201/04, and judgment in that case is expected on 17 September 2007.

The Commission's conclusion that Microsoft engaged in tying is based on the following test set out in Recital 794 of the Decision:

> "*Tying prohibited under Article 82 of the Treaty requires the presence of the following elements: (i) the tying and tied goods are two separate products; (ii) the undertaking concerned is dominant in the tying product market; (iii) the undertaking concerned does not give customers a choice to obtain the tying product without the tied product; and (iv) tying forecloses competition.*"

In addition to the above, a fifth element was recognised by the Commission in Recital 961 of the Decision, namely the absence of an objective justification.

Microsoft concedes that it was dominant in the market for client PC operating systems. However, Microsoft disputes the presence of each of the remaining elements. This paper presents a brief summary of Microsoft's and the Commission's positions regarding the tying claim, and also provides a brief overview of the history of the case and recent developments.

II. Microsoft's Position

In Microsoft's view, the tying part of the Decision directly challenges Microsoft's ability to engage in beneficial and pro-competitive conduct, as the Decision imposes limits on Microsoft's ability to meet consumer and industry demand for new and improved functionality with each new release of the Windows PC operating system and therefore match the ever improving offerings of operating system competitors like Apple or Linux. End users expect operating systems to offer new functionality as technology develops, much in the same way that they expect other consumer products to incorporate new functionality over time.[2] Similarly, third party developers of software applications and Web sites, who frequently rely on functionality present in an operating system instead of duplicating this functionality in their own programs and services,[3] also look to developers of operating systems to increase the platform functionality present in the operating system. Finally, third party PC manufacturers (generally referred to as "OEMs") want new functionality in operating systems and new programs relying on that functionality so that consumers will upgrade to new PCs. For these reasons, all developers of operating systems continually seek to improve their

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2 Just as consumers expect new mobile telephones to include new and improved functionality with each new model, they also expect new operating systems to do the same.

3 To encourage third party software developers to develop programs for Windows, and thereby increase the value of Windows, Microsoft freely exposes this functionality through publicly-available application program interfaces, or APIs. By calling on these APIs, third party software developers can seamlessly integrate this functionality in their own programs without having to devote time and resources to developing and testing alternative functionality. One example of an API exposed by Windows is the "Create Menu API". This API allows a software developer to insert the familiar pull-down menus that are common in software applications such as a word processing programme. Before this menu functionality was included in Windows, every third party software developer who wanted to use menus had to write their own software code to display menus.

operating systems and compete on this basis.

Although the theory of tying set forth in the Decision does not directly challenge Microsoft's ability to offer new functionality, it indirectly threatens this ability by preventing Microsoft from offering such improved functionality on a uniform basis. Microsoft believes that the primary consumer and industry benefits provided by the Windows PC operating system are dependent on the existence of a uniform development platform for third party software applications and Web sites, and that its policy of offering a uniform platform has been an essential element of its success. By offering a uniform platform, third-party software and Web site developers can be sure that programs and Web sites designed to run on Windows will in fact work on all PCs running Windows. This makes it significantly easier for third party developers to write programs and design Web sites for Windows, which helps explain why so many third party programs and services are available for Windows today. In addition to benefiting from a large number of inexpensive software programs and content-rich Web sites, end users also benefit from the uniform platform because they can be sure that third party software and services designed for Windows will work on their system. In contrast, if Microsoft made available different versions of its operating system platform, third party developers would need to separately develop, test and market different versions of their products for each different version of Windows. This would increase the costs of such software and make it more difficult for end users to know whether a given third party program works on their specific PC. Thus, Microsoft has continually strived to ensure that functionality is integrated and improved in Windows on a uniform basis.

In Microsoft's view, the product design that gave rise to the tying infringement in the Decision was beneficial and pro-competitive, just as Apple's own integration of multimedia features in the Mac OS also are beneficial and pro-competitive. Indeed, the Commission had never raised issues about other feature improvements in Windows. The Commission never raised any issue over the integration of media functionality as such into the Windows operating system, which Microsoft introduced as far back as 1992. In addition, the Commission never raised any issue with the integration of media functionality that could stream content over corporate networks, which Microsoft introduced in 1995, or even the integration of media functionality that could stream content over the Internet when this functionality was provided by a third party.[4] The Decision even allows Microsoft to contractually oblige OEMs to pre-install Windows and a media player (possibly WMP), provided the choice is left to OEMs.[5] It was only when, in 1999, Microsoft integrated in

[4] Between 1995 and 1998, Microsoft included a version of RealNetworks' streaming media player with each version of Windows. According to Recital 818 of the Decision, there is a difference between integrating one's own functionality and bundling third party functionality because, "*to tie another vendor's product would not appear to foreclose the chances of more efficient products*".

[5] In Recital 959, the Decision states that Microsoft could, consistently with Article 82 EC, enter "*into*

Windows its own media functionality for streaming audio and video content over the Internet that the Commission concluded that a "*very serious*" infringement of Article 82 EC occurred. In Microsoft's view, it cannot be a sensible interpretation of the EC competition law rules to treat this specific development in 1999 as so significant as to trigger on it an obligation to adopt a radical shift in its product design.

Finally, it should be noted that Microsoft accepts that, as a dominant undertaking in the market for PC operating systems, it has a special responsibility "*not to allow its conduct to impair genuine undistorted competition on the common market*".[6] Accordingly, Microsoft is careful to preserve opportunities for vendors of third party software (such as media players) to distribute their products. In fact, Microsoft goes to great efforts to ensure that Windows PC operating systems make it easy for third party software to work as designed, and even to be used as the "default" functionality instead of the functionality in Windows. There is no allegation in the Decision that Microsoft has impeded the performance of third party media players in any way. In addition, Microsoft does not inhibit PC manufacturers from installing or promoting any products they like on their PCs. Again, there is no allegation in the Decision that Microsoft prevented third party media players from agreeing with PC manufacturers to install their products on the PCs that they sell. Finally, Microsoft does not prevent end users from installing any third party software that they choose on their PCs, and from using this software in addition to, or instead of, functionality in Windows. Indeed, given that the success of Windows is dependent on making the functionality of Windows available and attractive to third parties, there are numerous third party software developers which simultaneously rely on functionality present in Windows and offer their own additional improvements to this same functionality in an attempt to sell their programs. Microsoft does not take any action to impede these developments.

III. Events Leading to the Commission Decision

Although it had not received a single complaint from third party developers of media players or from any Microsoft customer regarding the product design that triggered the tying infringement, the Commission nevertheless began an own-initiative investigation into Microsoft's decision to improve the media functionality already present in Windows. Further to this investigation, in August 2001, the Commission adopted a Statement of Objections, where, in the space of just over four pages, it accused Microsoft of infringing Article 82(b) and Article 82(d) EC by bundling "Windows Media Player" in Windows. Notably, the Statement of Objections did not cite to any market evidence to support its allegations, which is not surprising as there was no indication that the

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arrangements with OEMs to pre-install Windows and a media player (possibly WMP) on a client PC in order to meet the corresponding consumer demand".

6 *See, e.g.*, Case 322/81 *Michelin v Commission* ("*Michelin I*") [1983] ECR 3461.

Commission carried out any broad market investigation of the issues raised before reaching its preliminary conclusion.

Over a year after Microsoft's response to the August 2001 Statement of Objections, the Commission carried out a market investigation which consisted of a series of questions to Internet content providers and third party software developers regarding their reliance on functionality in Windows. Notably absent from this market investigation was any inquiry into whether there was demand for a version of Windows without the media functionality at issue, a fundamental issue underlying the Commission's theory of both "two products" and foreclosure.[7] With regard to the questions it did ask, the Commission only relied selectively on the evidence which supported its views, and relied on this evidence in a new "Supplementary" Statement of Objections that it adopted in August 2003.[8]

The August 2003 Statement of Objections also relied extensively on numerous statements from the U.S. company RealNetworks. Although RealNetworks was not a complainant, it became involved in the proceedings after the Commission adopted its August 2001 Statement of Objections. RealNetworks followed up on its involvement in the European proceedings by lodging a private suit in the U.S. seeking over US$ 1 billion. RealNetworks then subsequently pushed the Commission to reject any settlement proposal from Microsoft and to adopt a Decision, as is demonstrated by its statements welcoming the Decision:

> *"'Our lawyers tell me that (the Commission's ruling) will strengthen our private suit', [Rob Glaser, CEO of RealNetworks] said.*
>
> *[…]*
>
> *And although in negotiations with the Commission Microsoft had offered to provide several*

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7 The issue of demand for a version of Windows without the media functionality at issue is relevant to the Commission's theory of foreclosure since any claim of foreclosure must be causally linked to the impugned conduct. Put simply, if there was no demand for a version of Windows without the media functionality at issue, Microsoft's failure to offer such a version (the conduct which triggered the infringement) could not be said to have caused any foreclosure—the market would have operated in exactly the same way regardless of whether Microsoft engaged in the impugned conduct.

8 A thorough discussion of the failings of the Commission's survey (which, Microsoft has argued, relied on biased questions and selective reporting of answers) is beyond the scope of this paper. Nevertheless, two specific failings are particularly noteworthy. First, the August 2003 Statement of Objections alleged that content owners and providers were unlikely to support multiple formats, yet the Commission's own market investigation showed that all thirteen respondents to its questionnaire supported three of the four major formats. This result was not reported in the August 2003 Statement of Objections. Similarly, the Third Statement of Objections alleged that it costs more to write applications to support more than one media technology, whereas the Commission's own market investigation showed that 11 of the 14 respondents to its questionnaire supported at least two media technologies, with five supporting three. (Of the three that supported only one technology, one supported only Apple's QuickTime.) This result was also not reported in the August 2003 Statement of Objections.

different media players with its OS, Glaser believes that the Commission's final decision was the right course to take.

[…]

But despite RealNetworks' antitrust concerns, the company appears to be doing well and is expected to return to profitability this year, Glaser said."[9]

In line with RealNetworks' preferred strategy, the Commission ultimately adopted a Decision, having rejected a settlement Microsoft proposed that would oblige OEMs to distribute third party media players with Windows. As Commissioner Mario Monti explained at the time, a settlement was not possible because a precedent was needed that would apply to future conduct:

"I would like to stress the constructive and co-operative spirit displayed by Microsoft in the last few weeks. I also want to acknowledge the high degree of professionalism of the members of the Microsoft team at all levels.

We made substantial progress towards resolving the problems which have arisen in the past but we were unable to agree on commitments for future conduct."[10]

After the adoption of the Decision, and before the oral hearing in Case T-201/04, RealNetworks did negotiate a settlement with Microsoft. Notably, as part of the agreement RealNetworks did not require Microsoft to contractually require OEMs to distribute RealNetworks' media player, or require Microsoft to offer a version of Windows without media functionality. Instead, RealNetworks' antitrust concerns were addressed with a payment of US$ 761 million in cash and services, including promotional arrangements for RealNetwork's subscription music service. As a result of this settlement, no developer of media players identified in the Decision now supports the Commission's attempts to defend the Decision.

IV. The Commission Decision

As noted above, the Commission's Decision concluded that a tying claim under Article 82 EC requires the following elements: (i) the tying and tied goods are two separate products; (ii) the undertaking concerned is dominant in the tying product market; (iii) the undertaking concerned does not give customers a choice to obtain the tying product without the tied product; (iv) tying

9 "Real CEO says EU-MS ruling 'right,' may help lawsuit", http://www.thestandard.com/-article.php?story=20040407170330291 (5 July 2007).

10 Commissioner Monti's statement on Microsoft, IP/04/365.

forecloses competition and (v) there is no objective justification.[11]

The remainder of this paper will provide a brief summary of the disagreement between Microsoft and the Commission regarding each of these elements, which are likely to be addressed in the forthcoming CFI decision.

A. "The tying and tied goods are two separate products"

The first part of the Commission's test, that the tying and tied goods are two separate products, is generally accepted as an essential element of tying.

It is Microsoft's submission that the Commission has failed to establish this element because the alleged tying product (the Windows PC operating system) and alleged tied product ("Windows Media Player") constitute a single, integrated product. According to Microsoft, Windows Media Player is one of many integrated features in Windows, and the existence of two separate products can only be met if the Commission can show the existence of demand for the alleged tying product without the alleged tied product.[12]

For example, selling shoes with laces can only amount to tying if there is demand for shoes without laces. If customers only want to buy shoes with laces, this cannot amount to a tying practice (regardless of whether there exists an independent market for laces). In fact, prior to the adoption of the Decision, it seemed that Microsoft's view was entirely consistent with that of the Commission. In addressing the same issue in paragraph 216 of its own Vertical Restraints Guidelines, the Commission states as follows:

> *"What is to be considered as a distinct product is determined, first of all, by the demand of the buyers. Two products are distinct if, in the absence of tying, from the buyers' perspective the products are purchased by them on two different markets. For instance, since customers want to buy shoes with laces, it has become commercial usage for shoe*

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11 Recitals 792 and 831 of the Decision clearly establish that the tying infringement is based "*in particular*" on Article 82(d) EC. Nevertheless, the Commission disregarded the elements under Article 82(d) in favour of a new test. This paper focuses on the new test identified in the Decision.

12 In fact, even this test may be unduly restrictive, as it focuses on historic demand and could force dominant undertakings to freeze products in their current state. Thus, this test should arguably also include a factor requiring the Commission to take into account whether, in the foreseeable future, there is likely to be demand for the alleged tying product without the alleged tied product. The Commission acknowledged in Recital 808 of the Decision that its test could risk "*ignoring efficiency benefits from new product integration*", but concludes that this is not a concern here as, in "*the case of WMP, however, there is non-insignificant consumer demand for alternative players some four years after Microsoft started tying its streaming media players with Windows*". Thus, in trying to defend the "two product" element of tying, the Commission effectively undermines its theory of foreclosure. It is also notable that in footnote 938 of the Decision, the Commission suggests that integration which causes complete foreclosure (as the Commission claims occurred after Microsoft included support for the mouse-driven interface in Windows) would demonstrate that the foreclosed functionality is part of Windows, and thus demonstrate that there is no act of tying.

manufacturers to supply shoes with laces. Therefore, the sale of shoes with laces is not a tying practice."

Microsoft has repeatedly pointed out that there is no evidence that its customers (whether end users or OEMs) want to obtain PC operating systems (the "tying" product, analogous to shoes) without the streaming media functionality at issue (the "tied" product, analogous to laces). In fact, as already noted above, the Commission failed to even investigate this issue. Accordingly, in Microsoft's view the Commission cannot properly conclude that there is a distinct tying market for client PC operating systems without this streaming media functionality.

Recent events have only confirmed the inherent danger involved when the Commission does not rest its predictions on market evidence—in fact, the "unbundled" version of Windows that Microsoft was required to create to comply with the 2004 Decision (Windows XP N and Windows Vista N) has not seen any appreciable commercial demand. Not a single PC manufacturer has licensed it for installation on new PCs and consumer purchases at retail have been negligible.

The Commission's primary response to Microsoft's argument is to slightly amend this element. Rather than seeking to establish that "*the tying and tied goods are two separate products*" as stated in Recital 794 of the Decision, the Commission instead looks exclusively at whether there is a distinct market for the "tied" product, reasoning that one can infer from this a distinct market for the "tying" product without the "tied" product. In support of its interpretation, the Commission has tried to draw on the judgements of the Court of First Instance in *Hilti*[13] and *Tetra Pak II*[14]. According to the Commission, the Court of First Instance rejected similar "*integrative*" arguments raised by Hilti and Tetra Pak, concluding that tying existed under Article 82 EC simply because "*there existed independent manufacturers who specialised in the manufacture of the tied product, a fact which indicated that there was separate consumer demand and hence a distinct market for the tied product*" (Decision, ¶ 802).

This analysis fails to appreciate that the conduct involved in *Microsoft* is fundamentally different from *Hilti* and *Tetra Pak II* in a number of important ways. In *Hilti* and *Tetra Pak II*, it was commonly accepted that there was distinct demand for the "tying" product without the "tied" product. The fact that customers purchased third party consumables for use with Hilti's and Tetra Pak's primary products (nail guns/nail cartridges and liquid packaging machines) necessarily demonstrated that customers wanted to obtain the primary products without the consumables

13 Case T-30/89, *Hilti AG v. Commission* [1991] ECR II-1439.
14 Case T-83/91 *Tetra Pak International SA v. Commission* [1994] ECR II-755.

(nails and drinks cartons), because the consumables were homogenous[15] products purchased separately. In contrast, media functionality in Windows and third party media players is not homogeneous,[16] is not a consumable and is offered at no additional price by Microsoft or by any of the vendors of media playing applications software. Thus, customers can, and frequently do, use multiple media players. Accordingly, unlike the situations in *Hilti* and *Tetra Pak II*, consumer demand for the "tied" product from a third party in the Microsoft case does not logically demonstrate that consumers do not also want the alleged "tying" product with the alleged "tied" product—consumers generally will want both, as the lack of demand for Windows XP N and Windows Vista N further demonstrates.

The Commission has also argued that, to the extent that end users do want PC operating systems with streaming media functionality, such demand can be met by PC OEMs. According to Recital 959 of the Decision, "*OEMs act as purchasing agents for consumers in providing such bundles*", and thus the choice of whether to include the media functionality in Windows or a third party media player, however, should be left to the OEMs.

In Microsoft's view, the Commission has made a mistake in fact and in principle. First, the Commission's argument is factually incorrect because it is based on the notion that third party media players can easily replace the media functionality in Windows. In actuality, however, even if third party media players provide comparable end-user functionality, they cannot replace the platform functionality in Windows. Every developer designs software to work in a slightly different way, which means that the programming interfaces available to third parties will differ depending on the developer. Thus, third party programs and Web sites that rely on the media functionality in Windows would not work correctly if this media functionality was removed and replaced with a third party media player—programs and Web sites that rely specifically on Windows programming interfaces require the presence of that specific functionality in Windows. In addition, if Windows did not have a consistent set of media functionality, Microsoft itself could not rely on that functionality to enable other Windows features (such as Moviemaker) that require audio visual functionality.

Microsoft also believes that the Commission's argument is wrong in principle. Even dominant companies must be allowed to design their products to meet customer demand and attempt to match or improve upon the offerings of competitors. They should not be required to rely

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15 In this context, "homogenous" products are products that do not vary in their essential characteristics. While there may be differences in quality, nails and cartons are essentially identical to other nails and cartons, respectively, as they serve the same purpose.

16 For example, different media players support different media formats—an end user wanting to play a file encoded in RealNetworks' format must have RealNetworks' media player installed because RealNetworks has no commercial interest in licensing its formats for use with other media players. End users interested in playing the widest number of formats will therefore want more media players. In addition, end users will prefer the "look and feel" of certain media players more than others depending

on independent third parties to build the final product out of a series of different components from different sources—Article 82 EC should not be used to require Microsoft to allow third parties to sell their own make-shift versions of Windows. If customers demand operating systems with media functionality and all significant competitors offer operating systems with media functionality, nothing in Article 82 EC should restrict Microsoft's freedom to meet this demand and competition in the manner that it chooses.

The upcoming Microsoft judgment therefore raises a unique issue that has not previously been addressed by the Community Courts, and that is of interest to all industries that sell or license products that incorporate a number of integrated features: can the Commission meet its obligation to show the existence of two separate products simply by showing that one feature included the integrated product is also supplied separately? In Microsoft's view, this is too simplistic an analysis, and the Commission should be required to instead show that the integrated product without the feature also constitutes a separate product for which there is consumer demand. In the present case, no such showing has been made.

B. "The undertaking concerned is dominant in the tying product market"

As indicated above, Microsoft concedes that it is dominant in the market for client PC operating systems. Accordingly, except to the extent that the Commission defines the "tying" product as a client PC operating system without media functionality, the existence of this element is not in dispute.

C. "The undertaking concerned does not give customers a choice to obtain the tying product without the tied product"

Whether the third element of the Commission's test, that the undertaking concerned does not give customers a choice to obtain the tying product without the tied product, is a correct element of tying is subject to debate between the parties.

Microsoft first notes that, even if the Commission's identification of this element is correct, the Decision fails to establish this element because the Commission has incorrectly identified the "tying" product. In any event, Microsoft disputes the way in which this element, normally referred to as "coercion", has been identified by the Commission. According to Microsoft, there is no coercion (i.e., harm to end users) because end users are not required to pay anything extra for the media functionality in Windows, are not required to use the media functionality in Windows, and are not restricted from using third-party media players instead of, or in addition to, the media functionality in Windows. Thus, end users acquire the media functionality at issue with Windows, and they suffer no appreciable harm of the type that the competition rules are designed to protect.

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on the use to which the media player is put.

In Recitals 833 and 841 of the Decision, the Commission concedes these points, but considers them immaterial. In Recital 831 of the Decision, the Commission also accuses Microsoft of "*conflat[ing] the coercion and foreclosure of competition elements of tying*" when it argues that end users are not required to pay for the added functionality.[17] The Commission adds in Recital 832 of the Decision that end users are harmed because Microsoft's conduct undermines "*the structure of competition in media players which is liable to result in deterrence of innovation and eventual reduction in choice of competing media players*". The Decision then refers to its conclusions on foreclosure to support this view.

In Microsoft's view, it is the Commission, and not Microsoft, that improperly conflates the coercion and foreclosure elements of tying. The element of coercion is intended to focus on harm to end users, whereas the element of foreclosure is intended to focus on harm to the competitive process. Given the Commission's failure to allege any harm to end users other than the alleged harm to the competitive process, the Commission has failed to establish the element of coercion.

The upcoming Microsoft judgment therefore raises another unique issue that has not previously been addressed by the Community Courts: can the Commission conclude that there has been a tying infringement under Article 82 in the absence of a showing of direct harm to end users? In Microsoft's view, coercion should remain as an independent element of tying to ensure that the competition rules are applied to protect end users, and not competitors.

D. "Tying forecloses competition"

The fourth element of the Commission's test, that the alleged tie forecloses competition, is generally accepted as an essential element of tying.

In Microsoft's view, the Commission has failed to establish this element. As already noted, this case is contrary to all previous tying cases in that the conduct at issue does not directly foreclose any third parties. The existence of the media functionality in Windows does not prevent users from obtaining, installing and using any third party media player of their choosing, nor does it prevent PC manufacturers from pre-installing as many third party media players as they wish to install. In fact, the only evidence in the Commission's file demonstrated that consumers used an average of 1.7 third party media players (a figure that, for the avoidance of doubt, excludes usage of the media functionality in Windows), and that the largest OEMs pre-installed multiple media

[17] In footnote 971 of the Decision, the Commission also suggests that Microsoft may be hiding the price of the media functionality in the "*overall price for the bundle of Windows and WMP*". However, the Commission has since come to recognise that the correct price is zero, consistent with the practice of third party media player vendors (this also explains why there is no price difference between Windows XP and the "unbundled" Windows XP N), and consistent with its own conclusions in Case No COMP/M.1845 – AOL/Time Warner, 11 October 2000 (para. 63).

players on their PCs.[18]

It is again interesting to distinguish this case from other tying cases such as *Tetra Pak II*, which involved a contractual provision which required buyers of carton-filling equipment sold by Tetra Pak to buy all their requirements of cartons from Tetra Pak. As a result of Tetra Pak's practice, every carton Tetra Pak forced a customer to take was one carton less for Tetra Pak's competitors to sell to that customer. In other words, *Tetra Pak II* involved a zero-sum situation. In the present case, however, the essence of Microsoft's business model for Windows is to provide a platform for the creation of third-party software, even software that provides the same or similar functionality as Windows. Accordingly, Microsoft deliberately designed Windows to ensure that third-party developers could easily create third party media players, and consumers and PC manufacturers could install and use as many third party media players as they wished on their PCs.[19]

In fact, the Commission itself recognises the uniqueness of this case, distinguishing it from what it refers to as "*classical*" tying cases like *Hilti* and *Tetra Pak II*. Thus, in Recital 841 of the Decision, the Commission notes:

> *"While in classical tying cases, the Commission and Courts considered the foreclosure effect for competing vendors to be demonstrated by the bundling of a separate product with the dominant product, in the case at issue, users can and do to a certain extent obtain third party media players through the Internet, sometimes for free. There are therefore indeed good reasons <u>not</u> to assume without further analysis that tying WMP constitutes conduct which by its very nature is liable to foreclose competition."* (Emphasis in original)

In this unique, "non-classical" tying case, the Commission instead alleges that foreclosure is indirect.[20] The reasoning underlying this theory of indirect foreclosure essentially rests on three steps. The first step assumes that content providers will have an incentive to encode their content

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18 The Commission rejected evidence that Microsoft provided about PC OEM (which revealed the presence of RealNetworks' media player, in particular, on many different models of PCs) on the grounds that it contradicted a statement by RealNetworks that its media player was not pre-installed by any OEM in Europe (notably, the Commission did not carry out its own investigation of this issue). RealNetworks subsequently modified its earlier statement in a subsequent submission.

19 This case also differs from *Van den Bergh Foods*, another case on which the Commission has relied. In that case, the abuse lay in an exclusivity obligation imposed by Van den Bergh Foods on retail customers for ice cream. Thus, Van den Bergh Foods offered to retail stores an ice cream freezer free of charge on the condition that it be used exclusively to store Van Den Bergh's ice cream. The Court determined that this exclusivity provision directly foreclosed access to the market by Van den Bergh's competitors because a large number of retail stores would not be able to install another freezer due to space constraints. In contrast, there are no capacity constraints that prevent third party media players from being installed on any Windows PC (although the Commission initially raised this issue, it subsequently appears to have dropped it in light of Microsoft's evidence to the contrary), and Microsoft does not impose any exclusivity obligation.

20 This is clear from Recital 836 of the Decision, where the Commission rejects one of Microsoft's arguments on the grounds that "*Article 82 also applies to conduct which indirectly ties customers, thereby giving rise to exclusionary effects comparable to the ones stemming from 'direct' tying*".

in just one media format since they face additional costs if they want to make their audio and video content available to third parties in multiple media formats. The second step is that the one media format chosen by content providers will be the Windows Media format because the "ubiquity of Windows Media Player" means that this format can be played on virtually all PCs. The final step is that standardisation on the Windows Media format will eventually cause third party media players to die away.

Microsoft has demonstrated that this theory is flawed at every step. First, Microsoft has noted that the claim that content providers have an incentive to encode their content in just one media format is flatly inconsistent with the Commission's own evidence, which showed that all surveyed content providers encoded in multiple formats.[21] In fact, there is no evidence to suggest that it is prohibitively expensive to encode content in multiple formats. Indeed, during the hearing before the Court of First Instance, the President of the Association for Competitive Technology,[22] an intervener supporting Microsoft, demonstrated how quickly and easily one could convert content into different formats by using inexpensive software products.

Second, Microsoft has noted that the claim that content providers will be driven to the Windows Media format because of the so-called "ubiquity of Windows Media Player" is undermined by the Commission's own analysis in the *AOL/TimeWarner* merger case. In that case (which was decided in 2000, one year after Microsoft's alleged tying abuse began), the Commission analysed whether AOL/TimeWarner could become dominant in the market for media players given that AOL owned the media player Winamp and TimeWarner had a large music catalogue. In assessing this issue, the Commission considered what would result if the merged entity exclusively encoded TimeWarner's content in a format supported only by Winamp. Based on the reasoning underlying the Commission's foreclosure theory against Microsoft, one would have expected the Commission to conclude that such a prospect was unlikely because AOL/TimeWarner, like other content providers, would be inexorably led to encode its content in a media format supported by Windows. This is not, however, what the Commission concluded. Instead, the Commission concluded that AOL/TimeWarner could successfully adopt a strategy of encoding its content exclusively in a format supported by Winamp, leading Winamp, rather than Windows Media Player, to "*shortly become the most popular player in the world*".[23] Notably, the AOL/TimeWarner Decision makes no mention of the so-called "ubiquity of Windows Media Player" as a factor that could impede this process. The Commission apparently dismissed this concern on the grounds that "*music players*

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21 As noted in n.8 above, the Commission's own market investigation showed that all thirteen respondents to its questionnaire supported three of the four major formats.

22 The Association for Competitive Technology is a trade association that represents nearly 3,000 software developers, systems integrators, IT consulting and training firms, and e-businesses.

23 Case No COMP/M.1845 – AOL/Time Warner, 11 October 2000 (para. 63).

can be freely and easily downloaded on a PC, which may support more than one player".[24]

As anyone familiar with the online audio and video content industry knows, the Commission's analysis in AOL/TimeWarner was far more accurate than its analysis in *Microsoft*. The ease with which media players can be downloaded means that even those content providers who encode in a single format are not necessarily driven to Windows Media formats. Indeed, since the time of the Decision, Adobe's Flash Player, which the Commission did not include in its market analysis, has increased its market share at a rapid rate, and, according to a study commissioned by Adobe, has overtaken Windows Media Player. According to Adobe's Web site, "*Adobe® Flash® Player is the world's most pervasive software platform, reaching 98% of Internet-enabled desktops in mature markets as well as a wide range of devices*."[25] Adobe's success is consistent with the Commission's conclusion in AOL/TimeWarner that the widespread distribution of media functionality in Windows would not, of itself, drive all content providers to use Windows Media formats. Indeed, at the time of the Decision, the Commission itself exclusively encoded its video streaming content in RealNetworks' format, despite its obvious interest in ensuring the widest possible dissemination of information on its activities (the Commission has now also created a YouTube channel, which, like all content available on YouTube, is encoded exclusively in Flash formats).[26] The Commission's analysis also failed to take into account the wide range of devices other than PCs that consumers use to playback digital media content. For example, given the number of consumers that use Apple iPods or iPhones, content providers must increasingly make their content in Apple's AAC format supported by such devices.

In addition to these factual flaws, the Commission's analysis does not provide a coherent or consistent theory of liability. If, as the Commission suggests, the critical issue is format competition and content providers select a media format based on which format is most broadly supported on PCs, then the delivery method (i.e., whether the content is streamed or downloaded to a PC) is of no relevance. However, the Decision quite clearly identifies the beginning of the alleged abuse to be the time that Microsoft integrated "streaming" functionality in Windows, and does not fault Microsoft for integrating functionality that can play content that already has been downloaded.

Finally, the third step in the Commission's analysis, namely that standardisation on the

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24 *Id*.

25 This is based on a survey conducted by Millward Brown in March 2007. See http://www.adobe.com/products/player_census/flashplayer/.

26 An additional flaw with the Commission's argument is that the media functionality in Windows supports a large number of formats in addition to Windows Media formats, including such standards as .mp3 and .mpeg. Thus, even assuming, *quod non*, that content developers have an incentive to encode their content only in a format supported in Windows, they are free to choose a wide variety of formats also supported by third party media players. In this regard, it should also be noted that Windows even supported the RealNetworks formats until such time as RealNetworks decided it was contrary to its commercial interests to license the format to Microsoft.

Windows Media format would eventually cause third party media players to die away, is also flawed. As noted, Microsoft, unlike other format developers such as RealNetworks, makes available its media technology so that third parties may develop alternative media player applications that can play all content encoded in the Windows Media formats. The Commission itself recognised this in Recital 1035 of the Decision. Thus, even if the Windows Media format came to dominate the Internet, *quod non*, third parties such as RealNetworks could still develop their own media players capable of playing such content.

It has now been over eight years since Microsoft engaged in the conduct that the Commission predicted would lead to the elimination of third party media players. The concern expressed by the Commission in Recital 1071 that "*the market may already be tipping in favour of Windows Media Player*" has obviously not come to pass.

This raises the interesting issue of the burden of proof faced by the Commission. In *Microsoft*, the Commission rejected current market evidence, which showed a growing and healthy market, and instead based its finding of an infringement on a gloomier prospective analysis based on speculation about hypothetical chains of causation. For this reason, the foreclosure analysis in this case more closely approximates a merger analysis as opposed to an Article 82 EC infringement proceeding.

Unlike a merger case, however, the Commission's analysis in this case resulted in the imposition of a record fine on Microsoft. In these circumstances, it seems appropriate for the Community Courts to apply a particularly high burden of proof. At the very least, the Commission should be subject to a review by the Community Courts not dissimilar to that applied in Tetra Laval. In that case, the Court of Justice reasoned that their review should not only "*establish whether the evidence relied on is factually accurate, reliable and consistent, but also whether that evidence contains all the information which must be taken into account in order to assess a complex situation and whether it is capable of substantiating the conclusions drawn from it*".[27] In the present case the Commission fails this test, as it failed to take into account information (such as the results of its own surveys) that did not substantiate the pre-ordained conclusion it reached in the just over four pages dedicated to this issue in its August 2001 Statement of Objections.

E. "There is no objective justification"

The fifth element of the Commission's test, the absence of an objective justification, is generally accepted as an essential element of any infringement of Article 82 EC.

As noted earlier in this paper, integrating new functionality and improving existing functionality in an operating system is conduct that is both beneficial and pro-competitive. End

users, third parties and OEMs all expect that each release of Windows will include more and better functionality than was made available before. This point has been confirmed by the only exceptions—Windows XP N and Windows Vista N, both of which were designed by DG Competition, have been commercial failures precisely because they offer less functionality.

The Commission dismisses the benefits identified by Microsoft not because it doubts that they exist, but rather because it claims that they make Windows too attractive and thereby will cause Windows to become the platform of choice for third parties. It is clear from Recital 986 of the Decision that the integration of media functionality in Windows, which started in 1992, became an abuse as of May 1999 because, to repeat the Commission's words, "*Microsoft started to offer a product that matched competitors' products*". The fact that Microsoft improved the media functionality in Windows in a competitive manner is thus an essential component of the finding of abuse in this case. This cannot be a sensible interpretation of Article 82 EC.

As also pointed out, Microsoft is careful to preserve opportunities for vendors of third party software (such as media players) to distribute their products. Microsoft goes to great efforts to ensure that Windows PC operating systems make it easier for third parties to develop software and do not prevent third party software from working as designed, or even from being used as the "default" functionality instead of the functionality in Windows. What Microsoft does not do, however, is remove integrated functionality, as this would prevent end users and third parties from obtaining the benefits of the uniform platform.

In Microsoft's view, the Commission too easily dismissed the clear benefits that result from the impugned conduct, and incorrectly focussed its attention on the much more speculative theory of harm.

V. ***Quo Vadis*?**

As noted previously in this paper, the Decision imposed as a remedy on Microsoft a requirement to develop an "unbundled" version of Windows. In particular, Article 6(a) of the 2004 Decision provided that "*Microsoft Corporation shall, within 90 days of the date of notification of this Decision, offer a full-functioning version of the* Windows Client PC Operating System *which does not incorporate* Windows Media Player*; Microsoft Corporation retains the right to offer a bundle of the* Windows Client PC Operating System *and* Windows Media Player".

Following the rejection by the President of the Court of First Instance of Microsoft's application to suspend this requirement, Microsoft and the Commission engaged in a series of meetings and exchanges of correspondence to help clarify this requirement. During this period, the Commission provided very specific guidance to Microsoft, not only identifying which precise files

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[27] Case C-12/03 P, *Commission v. Tetra Laval BV* [2005] ECR I-987, para. 39.

were to be removed from this unbundled version, but even providing specific advice and recommendations for the name (ultimately called "N"[28]) and warning labels for the retail box.

As reported in various news articles, this version of Windows has been completely rejected by the market.[29] As Microsoft had argued to the Commission throughout the administrative proceedings, end users do not want versions of products that offer fewer features. Not a single PC manufacturer has licensed this version. The Commission, of course, could have avoided this embarrassment by investigating the existence of possible demand before reaching such a decision, instead of uncritically following the arguments of a third party, namely RealNetworks. As noted earlier in this paper, RealNetworks would seem to be the only real beneficiary of the Decision. However, this is not because the Decision improved the already ubiquitous and efficient distribution of RealNetworks' media player, but rather because, as their CEO confidently predicted at the time the Decision was announced, it strengthened their bargaining position with Microsoft in their U.S. litigation. RealNetworks ultimately negotiated a settlement with Microsoft. Ironically, the agreement did not require Microsoft to offer the "N" edition of Windows, but rather required Microsoft to further enhance its Windows Media platform such that RealNetworks could develop richer media experiences. RealNetworks then withdrew from the proceedings. The Commission again found itself alone in defending its position, just as it did when it first identified its concerns to Microsoft.

For its part, Microsoft has redoubled its efforts to avoid such allegations in the future. To take one example, on 19 July 2006 Microsoft publicly announced that it had embraced a set of voluntary principles to help guide the future development of Windows PC operating systems. These Principles, which consist of 12 tenets, are divided into three general categories:

- **Choice for Computer Manufacturers and Customers**. Microsoft is committed to designing Windows and licensing it on contractual terms so as to make it easy to install non-Microsoft programs and to configure Windows-based PCs to use non-Microsoft programs instead of or in addition to Windows features.
- **Opportunity for Developers**. Microsoft is committed to designing and licensing Windows (and all the parts of the Windows platform) on terms that create and preserve opportunities for applications developers and Web site creators to build innovative products on the Windows platform — including products that directly compete with Microsoft's own products.
- **Interoperability for Users**. Microsoft is committed to meeting customer interoperability needs and will do so in ways that enable customers to control their data and exchange

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28 For example, the Commission criticised the names "Windows XP Reduced Media Edition" and "Windows XP without Windows Media Player", believing these names focussed too much on the absence of this feature. Instead, the Commission suggested that Microsoft name the product with a neutral letter. Ultimately, the letter "N" was offered and accepted, with an explanation on the package explaining that "N" stands for "not with Windows Media Player".

29 *See*, e.g., "Microsoft says 'EU version' of Windows Vista a dud", http://www.itnews.com.au/newsstory.aspx?CIaNID=52560&src=site-marq (downloaded on 6 July 2007).

information securely and reliably across diverse computer systems and applications.[30]

As part of its efforts to avoid future concerns, Microsoft also kept the Commission (and other public authorities) appraised during the development of its latest operating system, Windows Vista. While the Commission announced that it would not give Microsoft a "green light" clearing Windows Vista prior to its distribution in Europe,[31] it did provide Microsoft with guidance on some issues. In response to this guidance, Microsoft made a number of changes to Windows Vista before its release in a manner that did not threaten the security and reliability of the product Thus, notwithstanding the disagreement between Microsoft and the Commission over the legal merits of the 2004 Decision, Microsoft has been, and continues to be, willing to listen to any concerns raised by the Commission and seek to resolve them in a constructive manner. Nevertheless, Microsoft hopes that the upcoming judgment of the Court of First Instance will vindicate its position, and minimise the risk that the principles underlying the 2004 Decision will be used to further fragment the Windows platform or to otherwise impede innovation throughout the industry.

30 The Principles are set out in full at: http://www.microsoft.com/presspass/newsroom/winxp/WindowsPrinciples.mspx.

31 "Competition: Commission statement on Microsoft Vista", MEMO/06/377.