European Union:

Infringement of Competition Rules: The Microsoft Case

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Executive Summary

After an extensive and arduous five-year long investigation, in March 2004 the European Commission, the EU antitrust enforcer, concluded that the U.S. corporation Microsoft has violated EU competition rules by abusing its dominant market position. In particular, the Commission held that Microsoft refused to provide to its competitors "interoperability" information and that it also made availablity of the Windows client personal computer operating system conditional on the simultaneous acquisition of the Windows Media player software. The initial fines imposed by the Commission amounted to 497,196,304 euros, approximately US$635 million.

In June 2004, Microsoft appealed the Commission's decision before the European Court of First Instance and asked for annulment of the Commission's decision. It also sought to suspend the Commission's decision by claiming immediate irreparable damage. The Court rejected Microsoft's claim to suspend the decision. The Court is expected to reach a decision on the appeal lodged by Microsoft by the end of 2007.

Since March 2004, a plethora of meetings, negotiations and exchanges of documents between Microsoft and the Commission failed to satisfy the Commission's requirements for compliance with its decision. Consequently, in July 2006, the Commission imposed additional penalties on Microsoft, a total of 280.5 million euros, based on a fine of 1.5 million euros per day from December 16, 2005 to June 20, 2006.

Currently, the dispute between the Commission and Microsoft focuses on the prices Microsoft charges for its protocols. The Commission claims that there is not sufficient innovation to justify the excessive pricing.

I. Introduction

Microsoft, a maker of various software products including operating systems for personal computers and servers, markets its products internationally. Any products reaching the European Union market fall within the ambit of jurisdiction and application of EU antitrust (competition) laws. The European Commission's Directorate General on Competition has the legal mandate to enforce competition rules, subject to review by the European Court of First Instance. The national competition authorities and domestic courts also have the power to enforce and apply EU and national law.

In the Microsoft case, the EU authorities have cooperated closely with the U.S. antitrust authorities.[1] The European Competition Commissioner, Neelie Kroes, recently pondered as to whether

[1] Based on agreement, it has been common practice for the European Commission's Directorate General for Competition and U.S. antitrust authorities at the Department of Justice and the Federal Trade Commission to cooperate in antitrust cases.

Microsoft should be broken up, because its tactics and maneuvers seem to defy the EU antitrust law. However, the EU has been urged by U.S. officials to proceed with caution in this direction.[2]

This report commences by providing an overview of the relevant EU competition rules that have been infringed by Microsoft, as stated in the Commission's decision, followed by a background on the case. Then, it provides a brief analysis of the Commission's 2004 decision against Microsoft. The compliance mechanism follows, with a chronology of events highlighting the battle between the two parties: the Commission in four Statements of Objection argues that Microsoft has basically failed to comply with its 2004 decision. On the other side, Microsoft asserts that it has done whatever possible to comply with the Commission's request to provide information to software vendors and furthermore that divulging additional information would be "akin to giving away its intellectual property."[3] The report concludes with a short description of the recent dispute, focusing on pricing of the protocols.

II. EU Competition Rules

The basic antitrust provisions are articles 81 and 82 of the EC Treaty (formerly 85 and 86). Regulation No 17/62[4] implemented the relevant articles on competition. On May 1, 2004, Regulation No 1/2003 replaced the 17/62 Regulation. The Commission found that Microsoft violated Article 82 of the EC Treaty[5] and Article 54 of the EEA Agreement[6] by engaging in activities which violated its dominant market position.

Article 82 reads as follows:

> Any abuse by one or more undertakings of a dominant position within the common market or in a substantial part of it shall be prohibited as incompatible with the common market insofar as it may affect trade between Member States. Such abuse may, in particular, consist in:
>
> (a) directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions;
>
> (b) limiting production, markets or technical development to the prejudice of consumers;
>
> (c) applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;
>
> (d) making the conclusion of contracts subject to acceptance by the other parties of supplementary obligations, which, by their nature or according to commercial usage, have no connection with the subject of such contracts.

In general, article 82 applies to abuse not only of a single firm's dominant position, but also to abuse by several companies acting in concert. In applying article 82, the first step is to define the relevant degree of economic power, or dominance. The EC Treaty does not provide a definition of "a dominant position." The Court of Justice examined the concept of market dominance in *Sirena v. Eda* and described it as the ability or power to hinder effective competition in an important part of the market, considering the position of producers or distributors of similar products. Market shares above eighty percent are very high and usually companies with such holdings are considered as having a dominant position. Microsoft had a 93.8 market share for PC operating systems in 2003-2004.

Having a dominant position is not against EU competition rules, unless an undertaking abuses its dominant position. As the court has stated:

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[2] *EU Urged Not To Break Up Microsoft*, REUTERS, May 7, 2007, *available at* http://news.zdnet.co.uk/itmanagement/0,1000000308,39286995,00.htm.

[3] Alex Woodie, *Microsoft Says EU Case All about Intellectual Property*, THE WINDOWS OBSERVER, May 3, 2006, *available at* http://www.itjungle.com/two/two/two050306-story07.html.

[4] 1962 OJ L 13 204.

[6] Article 54 of the EEA is similar to article 82 of the EC Treaty, *available at* http://secretariat.efta.int/Web/EuropeanEconomicArea/EEAAgreement/EEAAgreement/" \l "_Toc21163258 (last visited May 17, 2007).

> a finding that an undertaking has a dominant position is not in itself a recrimination but simply means, that irrespective of the reasons for which it has such a dominant position, the undertaking concerned has a special responsibility not to allow its conduct to impair genuine undistorted competition in the common market.[7]

Regulation 1/2003[8] implements the competition articles 81 and 82 and replaces the outdated Regulation No. 17/1962. The Regulation confers to the Commission specific powers to investigate infringement of the relevant competition articles and to issue decisions ordering companies to discontinue the infringement. During the investigation procedure, the Commission has the authority to request information from the undertakings which are subject to investigation, impose a deadline for submission, and determine the penalties to be imposed in case of incomplete, inaccurate, or misleading information. The Commission also has the power to inspect the premises of undertakings.

Fines and Periodic Penalty Payments

The most significant power is the Commission's authority to impose fines on undertakings not exceeding one percent of the total turnover in the previous year when companies supply incorrect or misleading information; when they infringe Article 81 or 82, the Commission has the right to impose fines not exceeding ten percent of the sum of the total turnover of the previous business year.[9] In order to end violation of the competition articles, the Commission has also the right to impose periodic penalty payments not exceeding five percent of the average daily turnover in the preceding business year per day, calculated from the date assigned in the Commission's decision.[10]

III. Background of the Microsoft Case

Early in 1998, a software company, Sun Microsystems Inc., and other U.S. companies, forwarded complaints to the European Commission, as the EU antitrust law enforcer, that Microsoft failed to disclose interface information necessary for Sun Corporation to develop products that could be suitable for Windows PCs and thereby be able to able to compete on an equal basis in the market.

In 2000, the European Commission, broadened its investigations to include allegations received by end-users and other Microsoft competitors. Specifically, the allegations focused on Microsoft's bundling its PC operating system with its own server software and other Microsoft software products ("middleware") in such a manner that allowed only Microsoft's products to be completely interoperable. Such practices were alleged to adversely affect competitors and consumers alike. Competitors, due to lack of access to the interfaces, would be placed at a disadvantage; at the same time, Microsoft would augment its dominance in PC operating systems for server operating system software and "middleware." Consumers would be de facto required to purchase Windows 2000 for servers in order to be able to exploit the functionalities of Windows 2000.[11]

Consequently, in February 2000, the Director General of Competition for the European Commission initiated an *ex officio* procedure against Microsoft for abuse of dominant position concerning its Windows 2000 software. On August 3, 2000, the European Commission forwarded a Statement of

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[7] Case 322/81, Michelin-Nederlandche Bande-Industrie Michelin v. Commission (1983) ECR 3461, as cited in DORIS HILDEBRAND, THE ROLE OF ECONOMIC ANALYSIS IN THE EC COMPETITION RULES 41 (2002).

[8] Council Regulation (EC) No. 1/2003 of Dec. 16, 2002, on the Implementation of the Rules on Competition Laid Down in Articles 81 and 82 of the Treaty, 2003 OJ L1, 1.

[9] *Id.*, art. 23.

[10] *Id.*, art. 24.

[11] Press Release, Commission Examines the Impact of Windows 2000 on Competition, IP/00/41 (Feb. 10, 2000), *available at* http://www.europa.eu/rapid/pressReleasesAction.do?reference=IP/00/141&format=HTML.

Objections to Microsoft. This is the first step in the opening of formal antitrust investigations.[12] Companies have a two-month period to respond in writing. They may also request that the Commission hear their case in an oral hearing within a month, after the Commission receives the written statement.

On August 6, 2003, the Commission sent the final Statement of Objection in which it addressed both issues: interoperability of its server and tying allegations. In October 2003, Microsoft refuted the evidence submitted by the Commission and called for an oral hearing, which took place in November 2003.

IV. Commission's Decision of March 24, 2004

On March 24, 2004, the Commission issued a 300-page decision that found Microsoft in violation of article 82 of the EC Treaty. The Commission established that Microsoft abused its dominant position by refusing to supply the specifications for protocols used by Windows work group server to its competitors and by tying Windows Media Player to the Windows operating system.

With regard to interoperability, the Commission reached the conclusion that Microsoft held a dominant position or quasi-monopoly. Pursuant to EU competition rules, the Commission had to establish that Microsoft abused its dominant position. The Commission relied on the *Volvo v. Veng case*, under which a manufacturer of cars refused to license its product designs so that other dealers could be able to make spare parts for the cars. In examining Microsoft's market practices, the Commission held that interoperability was a significant business tool contributing to Microsoft's huge success and profits in the market. In defending its position, Microsoft offered three alternatives that would produce the same results as interoperability with Windows: use of open industry standards supported in Windows, the distribution of client-side software, and the possibility of reserve engineering. In turn, the Commission rejected all these arguments.[13]

In addition, Microsoft argued that irrespective of antitrust rules and because of its intellectual property rights, it enjoys discretion regarding to whom to license its products. The Commission rejected this argument in favor of competition; more competition is beneficial to consumers and induces innovation. Moreover, the Commission noted that intellectual property rights have a twofold objective: a) to protect the creator's right to its work; and b) to stimulate creativity, which also promotes the public good.

With regard to the media player, the Commission, following the same way of reasoning as in the interoperability issue, concluded that Microsoft abused its dominant position not by offering a better product but by tying the Windows Media Player with Windows in an anticompetitive manner. This resulted in placing Microsoft at a competitive advantage in the media players field.

Pursuant to the decision, Microsoft was required to discontinue the above infringements and to also refrain from repeating the same act or conduct that had the same or equivalent effect. [14]

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[12] In parallel to the investigations undertaken by the European Commission, Microsoft was subject to a suit in the United States under the Sherman Act. In 1998-1999, the U.S. government, and a number of states along with the District of Columbia filed a suit against Microsoft. The plaintiffs claimed four violations of the Sherman Act: violation by entering into exclusive dealing arrangements; violation for tying Microsoft Internet Explorer to Windows; violation by having a monopoly in the personal computer operating system market; and violation for trying to monopolize the web browser market. The district court held in favor of the plaintiffs on violation for tying and on monopolization and attempted monopolization. It ruled against the plaintiffs on the exclusive dealing arrangements. For more information *see*: Bruce Canetti, *Microsoft Champions Intellectual Property Rights and Loses to European Union Competition Law: Proceeding Under Article 82 of the EC Treaty Case COMP/C-3-37.792 MICROSOFT, March 24, 2004*, 1 J .L. TECH. & POLICY 172 (2004).

[13] As summarized in Bruce Canetti, *id.*, at 174.

[14] Commission Decision, Mar. 24, 2004, relating to a proceding under Article 82 of the EC Treaty (Case COMP/C-3/37.792 Microsoft) C(2004)900 final, art. 4.

The Commission imposed the following remedies concerning interoperability and tying:

- As regards interoperability, Microsoft is required, within 120 days of the date of notification of the Decision, to disclose complete and accurate interface documentation which would allow non-Microsoft work group servers to achieve full interoperability with Windows PCs and servers. This will enable rival vendors to develop products that can compete on a level playing field in the work group server operating system market. Microsoft is required to ensure that the interoperability information that is made available is updated each time Microsoft brings new versions of its relevant products to the market.
- Microsoft is required to establish within 120 days an evaluation mechanism that will provide interested companies with a method to inform themselves on the scope and terms of use of the interoperability information.
- As regards tying, Microsoft is required, within 90 days, to offer PC manufacturers a version of its Windows client PC operating system without WMP. The un-tying remedy does not mean that consumers will obtain PCs and operating systems without media players. Most consumers purchase a PC from a PC manufacturer which has already put together on their behalf a bundle of an operating system and a media player. As a result of the Commission's remedy, the configuration of such bundles will reflect what consumers want, not what Microsoft imposes.

The first deadline regarding interoperability expired July 27, 2004, and the deadline regarding the tying expired June 28, 2004.

V. Microsoft's Appeal before the European Court of First Instance

Aggrieved parties have the right of recourse to the European Court of First Instance. On June 7, 2004, Microsoft filed an action against the Commission before the European Court of First Instance (CFI) contesting the decision and requesting that the Court: a) annul the Commission decision of March 24, 2004, or alternatively, annul or substantially reduce the imposed fines; and b) order the Commission to pay the costs.[15]

Microsoft argued in its plea that the Commission's findings are erroneous. It argued *inter alia* that the Commission was wrong in its findings that Microsoft violated article 82 EC by refusing to supply communications protocols to competitors and to permit the use of that technology in competing work group server operating systems. Microsoft also argued that the conditions required by the court before a dominant company must license its intellectual property rights were not met. With regard to the tying, Microsoft claimed that Windows and its media functionality are not two separate products and that the Commission failed to "demonstrate that the alleged tying and tied products are not connected naturally or by commercial usage."[16]

Subsequently, on June 25, 2004, Microsoft submitted an application for interim measures with the CFI, asking for the suspension of the operation of the decision pending the outcome of the proceedings. The Commission informed the President of the CFI that Microsoft had paid the fine.

In December 2004, the CFI rejected in its entirety Microsoft's request to suspend the application of the March 2004 decision because, in the court's opinion, there was not sufficient evidence that the remedies imposed by the Commission will cause immediate irreparable harm to Microsoft. The Court

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[15] 2004 OJ C 179/18 Case T-201/04.

[16] *Id.*, at 19.

ordered Microsoft to comply with the Commission's decision.[17] That meant in practical terms that Microsoft, in compliance with the Commission's decision and without undue delay, had to offer an unbundled version of Windows and also to make technical interface information available to competitors.[18]

On April 24-28, 2006, an oral hearing took place before the Grand Chamber of the CFI, after an exchange of written pleadings. On appeal, the issue before the court is whether Microsoft abused its dominant position in the market by bundling its Media Player software with the Windows operating system.

During the hearing on Microsoft's argument that the Commission was usurping the company's intellectual property rights, the Commission advocate reminded the Court that these rights claimed by Microsoft have not been proven and therefore the Court could not rely on them in rendering its judgment.[19] The advocate also clarified that the Commission did not ask the Court to order Microsoft to divulge its commercial secrets to competitors.

One of Microsoft's lawyers argued that the version of Windows without the pre-installed media players that was sent to Europe was not a successful product. Since only one of 20,000 copies of Windows XP sold in Europe was without the Media Player, Microsoft cannot not be accused of abusing its dominant position by offering a product that no one wants.[20]

It is expected that the Court's decision will have a bearing on how the Commission handles future cases dealing with software bundling issues.

VI. Compliance with the Commission's 2004

Since 2004, Microsoft, in voluminous responses to the Commission's criticism of failure to comply with the 2004 decision, basically argues that the 2004 Decision "does not require Microsoft to provide the Commission with the intellectual property licenses and extensive technical documentation requested."

On the other hand, the Commission charges that Microsoft has refused to provide complete and updated interoperability information, for which it was fined in 2006.

A spokesman for the Competition Commissioner, Jonathan Todd, remarked on April 11, 2007, "In 50 years of European anti-trust policy, this is the first time that we have been confronted with a company that has failed to comply with an anti-trust decision. … We don't want to be in a situation where ten years after an anti-trust decision, they still are not in compliance."[21]

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[17] Court of First Instance, Press Release No. 103/04, The President of the Court of First Instance Dismisses Microsoft's Application for Interim Measures (Dec. 22, 2004), *available at* http://curia.europa.eu/en/actu/communiques/cp04/aff/cp040103en.pdf.

[18] See Europa, Rapid, Press Release, Questions and Answers- Order of the president of the Court of First Instance in Case T-201/04 R. Microsoft Corp. vs European Commission, 12.22.04, MEMO /04/305 (Dec. 22, 2004), *available at* http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/04/305&format=HTML.

[19] Europe Information Service, *Competition: Crunch Time for EU Judges in Microsoft Appeal Case*, EUROPEAN REPORT, May 2, 2006,LEXIS/NEXIS, EUROPE Library, EISENG file.

[20] *Microsoft: Commission Forces Us to Make a Product No-One Wants*, EURACTIV, Apr. 26, 2006, *available at* http://www.euractiv.com/en/infosociety/microsoft-commission-forced-us-product-wants/article-154657.

[21] *Kroes Sounds Bugle for Next Microsoft Battle*, EURACTIV, Apr. 11, 2007, *available at* http://www.euractiv.com/en/competition/kroes-sounds-bugle-microsoft-battle/article-162156.

In complying with the 2004 decision, Microsoft submitted several technical documentations (specifications). Specifications describe certain characteristics of a program and must therefore be distinguished from the program's source code. In December 2004, Microsoft furnished the first draft of technical documentation concerning the implementation of the communications protocols to the Commission. [22]

In 2005, Microsoft prepared a draft of the licensing program for its Windows Server communications protocols and released versions of Windows in Europe without multimedia functionality (Windows XP Home Edition N and Windows XP Professional N). In order to ensure that Microsoft complies with the decision effectively and in a timely manner, the March 2004 Decision called on Microsoft to propose a suitable monitoring mechanism to assist the Commission to monitor implementation and a monitoring trustee independent from Microsoft. The Decision also envisioned the Commission's right to impose such a mechanism in case the one proposed by Microsoft was deemed unsuitable. An exchange of letters and various meetings between Microsoft and the Commission failed to establish a monitoring mechanism. Finally, on July 27, 2005, the Commission issued a Decision[23] regarding a monitoring mechanism and the procedure for appointing a trustee. The decision also specifies the rights and obligations of Microsoft vis-à-vis the trustee, as well as the obligations of the Trustee.[24]

In November 2005, the Commission adopted a decision against Microsoft claiming that Microsoft still had not complied with the 2004 decision on the issue of completeness and accuracy of the technical documentation of the communications protocols. Microsoft responded by providing revised technical documentation and data related to the pricing and grouping of protocol licenses.

In 2006, Microsoft announced that it will also make available a source code reference license to the technologies stated in the Commission's decision to any licensees in the European licensing program and that it will offer technical assistance to any licensees in Europe. It also filed a response to the Fourth Statement of Objection and had an oral hearing in Brussels on March 30-31, 2006.[25]

In November 2006, the Commission issued a statement that, as of that date, the technical data submitted by Microsoft did not meet the requirements of the 2004 decision.

VII. Recent Developments on Pricing

In compliance with the remedies of March 2004 decision, Microsoft provides two separate licensing arrangements to companies who want to obtain the interoperability information. Companies have the option to choose among these two licensing arrangements: a) a "No Patent Agreement" which permits licensees to use its protocols which carry the interoperability information, but without having a license for patents; and b) the "All IP Agreement," which combines the first license with a license for disputed patents.

Microsoft divided the protocols into Gold, Silver, and Bronze price groups, depending on the degree of innovation. Apparently, Microsoft had agreed that the price of these protocols would be based on their innovativeness. The 2004 Commission's decision had ordered Microsoft to make its Windows Server protocol technologies available on a "reasonable and non-discriminatory" basis.

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[22] *See Timeline of European Commission Case Against Microsoft*, MICROSOFT, Apr. 24, 2006, *available at* http://www.microsoft.com/presspass/legal/European/04-24-06eccasetimeline.mspx.

[23] Commission Decision of 07/28/2005 relating to a proceeding under Article 82 of the EC Treaty (Case COMP/C-3/37.792 Microsoft) C(2005) 2988 final.

[24] *Implementation of the Decision*, COMPETITION. http://ec.europa.eu/comm/competition/antitrust/cases/microsoft/implementation.html (last visited May 17, 2007).

[25] *Supra* note 6.

On March 1, 2007, the European Commission sent a Statement of Objection to Microsoft, in which the Commission rejected the documents submitted by Microsoft since December 2005, arguing that there is no significant innovation in the interoperability information, and consequently, concluded that the prices established by Microsoft are excessive.[26]

The Competition Commissioner, Neelie Kroes, stated that "the Commission's current view is that there is no significant innovation in these protocols. I am therefore again obliged to take formal measures to ensure that Microsoft complies with its obligations."[27]

On April 23, 2007, Microsoft replied to the Commission's Statement of objection regarding the pricing of licenses for the Workgroup Server protocol Program and stated that it will not request an oral hearing. According to Brad Smith, Senior Vice President and General Counsel of Microsoft Corporation, the company will focus on clarifying what prices the Commission wants Microsoft to charge, and therefore the company places more emphasis on constructive dialogue between Microsoft and the Commission.[28].

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[26] Press Release, Competition: Commission Warns Microsoft of Further Penalties over Unreasonable Pricing as Interoperability Information Lacks Significant Innovation, IP/07/269 (Mar. 1, 2007), *available at* http://europa.eu/rapid/pressReleasesAction.do?reference=IP/07/269.

[27] Kroes, *supra* note 21.

[28] Microsoft PressPass, *Microsoft Statement on Filing of Response to the European Commission's Statement of Objections on Protocol Pricing* (Apr. 23, 2007), *available at* http://www.microsoft.com/Presspass/press/2007/apr07/04-23ECRosponseFiling.mspx.

APPENDIX

DEFINITION OF TERMS USED IN THE 2004 COMMISSION DECISION REPORT

Interoperability information:

The complete and accurate specifications for all the Protocols implemented in Windows Work Group Server Operating Systems and that are used by Windows Work Group Servers to deliver file and print services and group and user administration services, including the Windows Domain Controller services, Active Directory services, and Group Policy services, to Windows Work Group Networks.

Protocol

A set of rules of interconnection and interaction between various instances of Windows Work Group Server Operating Systems

Windows Work Group Server

A computer connected to a network and on which a Windows Work Group Server Operating System is installed.

Windows Work Group Server Operating System

Any of the software products marketed by Microsoft Corporation as Windows NT Server 4.0, Windows 2000 Server, and Windows Server 2003 Standard Edition, and updates and successors to the latter,(including without limitation, security patches), as well as updates and upgrades to such successors.