

# Agenda

Advancing economics in business

## Microsoft versus the Commission: with great power comes great responsibility

In the Spiderman stories we are told that ‘with great power comes great responsibility’. The Court of First Instance has confirmed that dominant firms such as Microsoft have a special responsibility to help their rivals. Dr Philip Marsden, Director of the Competition Law Forum and Senior Research Fellow at the British Institute of International and Comparative Law, suggests that the European Commission should be even more responsible when proceeding against dominant firms and issuing guidance on Article 82

The Grand Chamber of the Court of First Instance (CFI) has ruled.<sup>1</sup> We have clarity and closure of a sort. Microsoft has signalled that it will not appeal, so now we pick over the judgment. Initially, the rhetoric was high, with talk of European discrimination against American companies. This was misguided: the complainants—RealNetworks, Sun, Novell, IBM and Oracle—are all US-based. There are more substantive concerns, however.

The two abuses alleged by the Commission were confirmed by the CFI as meriting a record fine of €497.2m, since:

Microsoft committed a single infringement, namely the application of a strategy consisting in leveraging its dominant position on the client PC operating systems market. (para 1,327)

### The tying abuse

The CFI found that the Commission had proven that:

- i) Microsoft tied two separate products (Windows and Media Player);
- ii) Windows was dominant in the operating system market, and customers who bought it were ‘coerced’ into taking Media Player as well;
- iii) this foreclosed competition in the market for media players; and
- iv) was not objectively justifiable.

The Court was thus unmoved by Microsoft’s arguments that, among other things:

- i) the products were not separate—ie, Windows just had media functionality, so there could be no ‘tie’; and

although there was separate demand for an operating system and for media players, there was no demand for an operating system without a media player (the ‘laceless shoes’ argument);

- ii) customers who bought Windows received Media Player but were not forced to use it and could readily download rival players;
- iii) such players had thrived during the period of the abuse (the most popular currently being Flashplayer); and that
- iv) product improvement was an objectively justifiable strategy for a dominant firm and to disallow it would only guarantee consumers degraded products with less functionality.

The CFI upheld the Commission’s remedy of requiring that Microsoft create Windows XPN—ie, Windows without Media Player—for the European market, and sell it for the same price as Windows XP. The Commission had rejected Microsoft’s offer to ship Windows with a CD of competing media players, rather than degrade its own product. Going forward then, Microsoft is free to add new functionality to Windows or Vista, so long as it provides European consumers with a product without such improvements.

### Refusal to deal: a tangled web

The CFI began by giving Microsoft the benefit of the doubt that its interoperability protocols were protected intellectual property (IP), a fact that was disputed by the complainants. The Court agreed that Microsoft could only be forced to divulge such information in ‘exceptional circumstances’. Building on case law such as *Magill* and *IMS Health*, the CFI found such exceptional circumstances, since:<sup>2</sup>

Based on an article by Dr Philip Marsden published in *Competition Law Insight*, October 2007. The views expressed are those of the author.

- i) the information refused was *indispensable* for competitors to develop competing products and *remain viable*;
- ii) the refusal led to a risk that effective competition would be eliminated;
- iii) the refusal prevented the potential emergence of new or merely *different* products; and
- iv) there was no objective justification for the refusal.

The CFI was therefore not convinced by Microsoft's arguments that:

- i) competitors were currently designing new products without access to the protocols;
- ii) Commission intervention in IP rights should be based on a likelihood, rather than a mere risk, of harm;
- iii) access to the protocols would allow rivals to clone Microsoft's operating system or applications;
- iv) forced sharing of its proprietary information would reduce its incentives to innovate.

As a result, Microsoft must provide its rivals with access to its protocols. Since the Monitoring Trustee opined that they have no innovative value, but were just arbitrarily selected communications protocols, Microsoft was told to provide access for free. The CFI, however, found that the Commission could not grant the Trustee the powers it had; perhaps some aspects of his work may be questioned.

## Commentary

It is surprising that such a technical case contains so little economic analysis, or real-world concern for consumer welfare. The Commission's theories of indirect harm to the effective structure of competition, and potential innovation and consumer choice, are repeatedly asserted. But the CFI did not test the Commission's theories, while the market evidence flatly disproves them. Microsoft retains a dominant share of the operating system market, but technological advances by rivals have leapfrogged many of its products, despite a supposed lack of access to its protocols (which is also refuted by several innovators, after having paid for such access as licensees). Nevertheless, European consumers must be offered a product with less functionality, thereby distracting Microsoft's designers, while not meeting consumer demand.

### Bucking the trend for more economic effects-based tests for consumer harm

Since the *Microsoft* case was brought almost ten years ago, the European Commission has modernised its approach to enforcement of competition law.<sup>3</sup> By delegating more powers to the national authorities and courts, decision-making is more timely, focused and

efficient. Economic effects are more relevant. Rather than asking whether mergers create or maintain a dominant position, authorities check to see if they significantly impede competition. Companies no longer have to seek pre-approval for their distribution agreements, based on formalistic criteria; the authorities are concerned only about the effects that agreements have on competition. Even with Article 82, the Commission's discussion paper made strides towards a more effects-based, economic approach.<sup>4</sup> The Commission did not go all the way, however, and was rightly awaiting the Court's ruling in *Microsoft* before releasing any further guidance.

### What guidance on harm to competition?

What theories of harm did the Court accept? It is a complicated case, but certain paragraphs stand out and build on past case law. In recent abuse cases, such as *British Airways* and *Michelin*, the European Courts have upheld a concern for the 'effective competitive structure' and competition 'as an institution'.<sup>5</sup> Dominant firms have therefore been condemned for offering innovative rebates which their competitors could not match. Consumers should pay a bit more, it seems, to ensure that other competitors can survive. Choice comes at a price, a price that does not accord with allocative efficiency, but with what is required in order to maintain less efficient rivals in the market.

In the *Microsoft* judgment, the CFI followed this theory of harm, ruling that:

it must be borne in mind that it is settled case-law that Article 82 EC covers not only practices which may prejudice consumers directly but *also those which indirectly prejudice them by impairing an effective competitive structure*. In this case, Microsoft impaired the *effective competitive structure* on the work group server operating systems market *by acquiring a significant market share* on that market. (para 664, emphasis added)

Is acquiring market share now an abuse? Some will argue that this paragraph should only be read in context, as a judicial reminder that the Commission need not demonstrate that Microsoft's refusal prejudiced consumers (para 660). The focus on indirect consumer harm by impairing market structure is a historical, 'ordoliberal' concern in Europe, which promotes the 'economic freedom' of competitors, rather than a narrow focus on consumer harm through high prices. While reasonable people can disagree about the propriety of such a focus in *global* product markets, that is the law in the EC. The European preference is precautionary and, as such, the CFI upheld the Commission's right to

intervene if there is a 'risk' of impairing that structure of competition, rather than checking if it is likely, or may in turn harm consumers. The judgment's requirement that dominant firms ensure that their competitors remain 'viable' is another development of the ordoliberal approach. However, the CFI's focus in paragraph 664 on market share is truly shocking.

### One big bad, few small good?

Are increased sales an offence now? Is success an offence? Is dominance itself an abuse? Before rejecting such fears as alarmist, let us examine the Commissioner's own reactions on judgment day.

Neelie Kroes said:

Let us be clear, first of all, that when we observe a situation where one producer has 95 per cent of the market, we are talking about a monopoly ... and that is not acceptable, and that is the point, you cannot expect that a competitor can be interested in entering into such a market, and that is really what we have seen. And we have complaints from those competitors, and so how can you measure whether things are working better. Well, a market share of much less than 95 per cent would be a way of measuring success. Now you cannot draw a line and say, well, exactly 50 is correct, but *a significant drop in market share is what we would like to see.*<sup>6</sup>

However, the Commissioner's spokesman, Jonathan Todd, was quick to try to clarify that Commissioner Kroes meant that:

once the illegal abuse has been removed and competitors are free to compete on the merits, the logical consequence of that would be to expect Microsoft's market share to fall.<sup>7</sup>

That is not really the end of the matter though. It seems that we have an insight into how the Commissioner really thinks about this company, and perhaps about all large firms. Mr Todd's clarification does not offer any comfort: if Microsoft's share does not fall as expected, couldn't the Commission 'logically' conclude that the abuse had not come to an end? Hopefully not.

Presumably, the Commission would require more than that before bringing a case—but how much more? Commissioner Kroes also stated after the judgment that:

I'm not expecting a large number of companies coming in for coffee and a chat but, if they think they've got a slight chance, they're very welcome.<sup>8</sup>

This is also worrying. The bar for antitrust complaints should be set considerably higher than that. 'Antitrust

injury' should be alleged at the very least, and should be based on something more concrete than speculative theories of harm to competitors. Actual harm to consumers need not be shown, but a credible story of such harm—albeit indirect—should be required before bringing the powers of the Commission—investigative and remedial—to bear on dominant firms. Otherwise companies can co-opt competition authorities into bringing strategic actions against their rivals, rather than competing in the marketplace.

### Case handling based on consumer harm

The Commission's Article 82 discussion paper made it clear that:

With regard to exclusionary abuses, the objective of Article 82 is *the protection of competition on the market as a means of enhancing consumer welfare and of ensuring an efficient allocation of resources.* (emphasis added)

This should be the basis of any complaint to the European Commission about abuse of dominance. Indeed, the Commission should use it to prioritise its cases. When it is rewriting its guidance, the Commission has to move away from the language the Court used about acquiring market share. It must make it clear that competition is about the most efficient companies having an opportunity to compete and win in the marketplace. The Article 82 discussion paper has a theory of harm that is at odds with this, suggesting that:

it may sometimes be necessary in the consumers' interest to also protect competitors that are *not (yet) as efficient* as the dominant firm. (emphasis added)

This seems to be what is going on in the *Microsoft* case. Windows has become the most efficient distribution channel for computer applications: it is the desktop of choice. The Commission was concerned that its ubiquity—its success—made it a de facto standard that competitors had to be able to access if their potentially better products were to compete on the merits. When faced with clear harm (to IP) for speculative gain (of inventions not yet invented), the authorities should exert more self-discipline. Not-yet-as-efficient rivals will never match the success of the dominant firm if they rely on the dead hand of government intervention. Nor will handicapping the successful ever promote an evolutionary contest of the fittest.

The *Microsoft* judgment is a signal reminder of the Commission's own great power: to levy massive fines and periodic penalty payments, to unbundle product designs, and to order IP to be shared. Commissioner Kroes has also hinted at more drastic action. Discussing Microsoft in April she stated that:

we have never had an experience like this one. A breakup, or 'structural remedy' may be appropriate when other measures fail.<sup>9</sup>

Such power is still beyond the grasp of the Commissioner. But the responsibility is there right now. We need a clear restatement that Article 82 controls abuses, not market share. If the Commission is serious about modernising Article 82 enforcement, it should back up its rhetoric of consumer harm with evidence, rather

than speculative theories and remedies which demean product offerings rather than foster innovation. Maybe then Europe will come to lead the world in high-tech companies, rather than as a forum for regulatory intervention.

The Commission has great power; let it now show more responsibility, and intervene only when it can prove credible stories of consumer harm.

**Philip Marsden**

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<sup>1</sup> C-T201/04 *Microsoft v. Commission*, Judgment of September 17th 2007.

<sup>2</sup> C-241/91 P and C-242/91 P *RTE and ITP v Commission* [1995] ECR I-743 ('*Magill*'), and C-418/01 *IMS Health* [2004] ECR I-5039.

<sup>3</sup> See 'The Power of Ideas: The Commissioner and the Influence of Defunct Economists', by Dr Gunnar Niels, also in this month's *Agenda*.

<sup>4</sup> European Commission (2005), 'DG Competition Discussion Paper on the Application of Article 82 of the Treaty to Exclusionary Abuses', December.

<sup>5</sup> C-95/04 P, *British Airways v. Commission*, unreported, ECJ Judgment of March 15th 2007, and C- T-203/01, *Michelin v. Commission* [2003] ECR II-4071, CFI Judgment of September 30th 2003.

<sup>6</sup> Reported by Castle, S. and Bilefsky, D. (2007), 'Litigation Capital of the World: EU vs. Microsoft', *International Herald Tribune*, September 18th. Emphasis added.

<sup>7</sup> *Ibid.*

<sup>8</sup> Reported by Gow, D. (2007), 'Armageddon for IT Firms?', *Guardian Unlimited*, September 19th.

<sup>9</sup> Reported by Newman, M. and Bodoni, S., *Bloomberg*, September 18th 2007.

If you have any questions regarding the issues raised in this article, please contact the editor, Derek Holt: tel +44 (0) 1865 253 000 or email [d\\_holt@oxera.com](mailto:d_holt@oxera.com)

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