Microsoft Judgment 17 September 2007

Introduction

This note addresses the two most important legal issues arising from the CFI Judgment in Microsoft and the legal ramifications of them.

In remarking on the Judgment, Brad Smith, General Counsel of Microsoft accurately said, "*this decision will occupy, as it should, the thoughts and discussion of many people, not just in the weeks ahead, but in the months and years to follow. It is one of these decisions that has that kind of extraordinary impact*".

Background

On Monday 17 September 2007, 13 judges in Luxembourg at the Court of First Instance ("**CFI**") unanimously agreed with the European Commission (**"Commission"**) that Microsoft had twice infringed the EU antitrust rules by (1) not supplying sufficient interoperability data to its rivals and (2) only selling its Windows client PC operating system (**"O/S"**) with Windows Media Player embedded into it.[1] The CFI held that Microsoft was indeed guilty of abusing its dominant position contrary to Article 82 EC in the markets for client PC O/S's and work group server O/S's.[2] Furthermore, the CFI upheld the original fine of €497,196,304[3] observing that there was no new interpretation of EU antitrust rules and therefore no reduction in the fine for novelty. The only rebuke to the Commission's Decision of 24 March 2004 concerned certain technical aspects of the provision dealing with the monitoring trustee. The CFI held that the Commission had been wrong to force Microsoft to accept an independent trustee - Professor Neil Barrett of Imperial College - to monitor its compliance. But Microsoft will have to propose its own trustee - and pay for him or her. Finally, the CFI held that Microsoft pay its own costs and 80% of those of the Commission. Microsoft has two months and 10 days to appeal to the European Court of Justice but has indicated that it may not do so.

1 Judgment in Case T-201/04, Microsoft Corp. v Commission of the European Communities.

2 Microsoft's market share at the time of the Decision was over 90% in client PC O/S and at least 60% in workgroup server O/S.

3 Microsoft's gross profit in Fiscal Year 2006 was $40.43 billion. €497 million is less than a week's gross profit.

The legal issues

The two most important legal issues arising from the Judgment concern the extent to which companies may be compelled to grant a licence of their intellectual property rights (**"IPR"**) to third parties and the extent of the legal test on bundling, or tying.

IPR licensing - Is there a new obligation to supply all-comers?

No.

The CFI reaffirms the principles of EC case precedent. In principle, companies are free to choose their business partners. Nevertheless, in certain exceptional circumstances a refusal to supply on the part of a dominant company will be abusive. In the Microsoft case, the refusal to supply concerned the interoperability information required by competitors to allow their products to communicate with the dominant Microsoft O/S. This was termed a refusal to license an IPR by the Commission in its Decision. According to previous case-law[4], exceptional circumstances must include the indispensable nature of the licensed product to exercise an activity on a neighbouring market; the elimination of effective competition on that neighbouring market; and the prevention of a new product emerging for which there is consumer demand. The CFI found that the criteria for exceptional circumstances were satisfied in Microsoft accordingly that it did not need to decide whether or not the information was IPR or if other factors constituted exceptional circumstances.

In respect of the three criteria for exceptional circumstances, the CFI found:

- **Indispensability:** this criterion entails an examination of the degree of information necessary to remain as a viable competitor and of whether the withheld information is the only economically viable source. On the facts, none of Microsoft's recommendations or solutions to interoperability made it possible for rivals to achieve the high degree of interoperability required. The withheld information can be indispensable notwithstanding the fact that competition is eliminated gradually and not immediately. Accordingly if a dominant company's refusal to license means it gradually knocks-out competitors and the withheld information cannot be reasonably obtained from other sources, it is most likely indispensable information.
- **Elimination of competition:** this does not mean complete elimination. The risk or likelihood of elimination of effective competition is sufficient. The fact that marginal competition may remain does not rebut this risk.[5]
- **New product:** the refusal must prevent the appearance of a new product for which there is potential consumer demand. This criteria will be satisfied where the refusal limits production, markets or technical development. In this respect the CFI expanded on the jurisprudence in *Magill* and *IMS Health*. In those cases it was decided that the 'new product' criteria was satisfied only where the refusal to deal prevented the development of a secondary market. On the facts, the CFI held that Microsoft's refusal to limit technical development could have prevented a new product from emerging and so the 'new product' criteria was met. Accordingly if a refusal to license limits technical development to the detriment of consumer choice, directly, or indirectly by upsetting an effective competitive structure, the new product criteria will be satisfied.

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4 *Magill*, Joined Cases C-241/91 P and C-242/91 P [1995] ECR I-743; *IMS Health*, Case 418/01 [2004] ECR I-5039; *Bronner*, Case C-7/97 [1998] ECR I-7791.

5 In this case, Microsoft's competitors had up to 10% of the client PC O/S market and up to 40% of the workgroup server O/S market.

Having failed to disprove the exceptional circumstances, Microsoft had to prove that its conduct was objectively justified if it was to escape an infringement of Article 82. The fact that it may have held IPR in the interoperability information was irrelevant, following *Magill* and *IMS Health*. The CFI held that even if the technology concerned is secret, and of great value to licensees and contains important innovations (which Microsoft's did not – it was secret but not innovative), these are not objective justifications. Indeed, the CFI considered that disclosure would not negatively impact on Microsoft's incentives to innovate. Finally, the CFI approved of the Commission's consideration that the remedy to supply did not envisage cloning of Microsoft's products; that disclosure of information was widespread practice already and met the requirements of the legal protection of computer programmes Directive[6]; and that previous commitments in the same field were not substantially different.[7]

In conclusion, the CFI rejected Microsoft's claim that the degree of interoperability required was intended in reality to enable competing workgroup-server O/S to function in every respect like a Windows system, and accordingly, to enable Microsoft's competitors to clone or reproduce its products.

Can it be abusive for a dominant company to make the sale of one product conditional on the purchase of another?

Yes.

Microsoft was super dominant in Windows PC O/S (over 95% of the market) and tied the sale of that product to the purchase by consumers of Microsoft's Windows Media Player - WMP.

In its assessment of whether or not this practice was abusive the Commission had examined four criteria on the basis of settled case law. The CFI confirmed the Commission was right in its assessment and in so doing reaffirmed when tying will be abusive. The criteria are as follows:

- the tying product (Windows O/S) and the tied product (WMP) are two separate product markets;
- the undertaking concerned is dominant in the market for the tying product;
- consumers cannot obtain the tying product without the tied product; and
- competition is foreclosed in the market for the tied product.

Legal landscape going forward for the I.T. industry and for other dominant companies

The substantial media attention this case has attracted gives the Commission's victory an additional piquance. Whilst the case does not develop existing case law in this area it is very valuable in so far as it reaffirms the existing principles in relation to refusals to grant access to IPRs and tying abuses.

The Commission's success in this case is likely to influence its activities. It is likely to increase the Commission's confidence to pursue dominant companies for allegedly abusive conduct.

6 Directive 91/250.

7 This refers to the IBM 1984 commitments to the Commission.

Dominant companies in the I.T. industry, may be particularly affected by this ruling. Today, Apple has around 70% market share for digital music; iTunes is the leading source for music on the internet; the iPod is the leading hardware device for digital music; and Adobe Flash is the leading internet-based technology for the streaming of media. Apple has a 70 % market share for digital music in Europe; Google has a 70-80 % share for search – in some countries in Europe, it has over a 90 % share. IBM has 99-100 % share for mainframe computers in Europe and the rest of the world.

The case highlights that multi-national firms with high shares in their markets need to either adapt business strategies to conform to the legal rules of different jurisdictions, or adopt global policies that conform to the standards of the most stringent, which, with its focus on protecting competitors, could be the EU. If so, the EU may become a location for forum shopping by companies with antitrust complaints against their competitors, especially since in a global economy any decision in Europe would likely have a worldwide effect on an individual company's policy.

The Commission continues to watch the I.T. industry very carefully. It is expected to step up its cases against three other US technology groups - Intel, the dominant microprocessor manufacturer, and fellow chip-makers Rambus and Qualcomm. It is also investigating whether Apple and major record labels are engaging in unfair pricing practices for digital media.

As for private enforcement actions in the national courts, the original complainant Sun Microsystems, Inc. signed up, on 12 September 2007, as a Windows Server OEM. Additionally, Sun and Microsoft agreed to collaborate to further enable deployment of Windows Server on Sun x64 systems. It therefore seems highly unlikely that Sun will pursue Microsoft for damages, but claims by other software providers cannot yet be ruled out.

Finally, this victory for the Commission may encourage it to take a bold position on these issues in the ongoing review of Article 82 and in the Commission's guidelines on the application of the same, when they eventually become formalised.

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September 2007