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**The Microsoft Decision - promoting innovation**

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Ladies and gentleman,

I am grateful for the opportunity to be able to talk today on the Commission's Microsoft Decision of March this year. I saw that the title given to my speech by the conference organisers was "*The Microsoft Decision: discouraging innovation?*". Naturally, this is not something that the Commission believes is a consequence of the Decision, but I was happy at least to note that there was a question mark at the end of the original title.

What I therefore intend to talk about in my speech is the thinking behind the main elements of the Commission's Decision, and particularly with regard to its effects on innovation in the market.

As a preliminary remark though, I must start with a *caveat*. As you will be aware, the President of the Court of First Instance is currently considering Microsoft's application for interim measures pending its appeal on the substance of the case. For Microsoft to be successful in its application, it must, amongst other things, prove that serious and irreparable damage will occur to it if the Decision's remedies are implemented immediately. Unfortunately, I cannot comment specifically on the arguments that have been made before the Court of First Instance, since the matter is *sub judice*. I will therefore limit my presentation to the issue of how the Decision examined the question of innovation in the market, and what the general implications of the Decision are in the future.

Let me first start by briefly summarising the Decision. There may even be one or two people here who have not yet read the full 300-page text.

The Decision first concluded that Microsoft held a dominant position in the market for PC operating systems, the software that runs today's PCs. This conclusion, which Microsoft does not dispute, was made on the basis of Microsoft's market share of around 95%, and the network effects in the market which protect Microsoft's market position. These network effects relate to the fact that the vast majority of PC applications in the

market are written for the Windows PC operating system. Microsoft's position in the market is therefore protected by what is known as the "applications barrier to entry."

Let me now turn to the abuse. The Decision found that Microsoft had abused its dominant position in two ways.

Firstly, Microsoft had withheld from competitors in the "work group server operating system market" interface information necessary for their products to interoperate or "talk" properly with Microsoft's PCs, and hence to compete viably in the market. The remedy ordered for this interoperability abuse requires Microsoft to disclose the interface information that it has refused to supply, and allow its use for the development of compatible server products by rival vendors. This information includes firstly, "PC-to-server" interfaces, and secondly, certain "server-to-server" interfaces, because there will very often be communication between servers in a network which relates to their interaction with PCs. To the extent that Microsoft has intellectual property in the EEA over these interfaces, it would be allowed to charge a reasonable, non-discriminatory royalty.

Secondly, the Decision found that Microsoft had harmed competition through the bundling of its separate Windows Media Player product with its Windows PC operating system. Windows Media Player's ubiquitous presence therefore creates artificial incentives for content providers and software developers to rely exclusively on Windows Media technology, and therefore does not allow rival media players to compete on the merits on the basis of their price and quality. The remedy ordered for this tying abuse requires Microsoft to provide a version of Windows which does not include Windows Media Player - in other words, untying. PC manufacturers and consumers can thus obtain Windows with the media player of their choice. Microsoft is still allowed to offer a bundled version of Windows which includes Windows Media Player.

I will now look at each of these areas of abuse in turn in the context of what their implications are for innovation in the market. First, interoperability.

Well, in this respect, it is argued that the very fact that the information at stake is likely to be protected by intellectual property casts a long shadow over the incentives of a dominant company, in this instance, Microsoft, to innovate in the market. According to this argument, a company will not want to take risks to bring products that would be protected by

intellectual property to the market if it thinks that the regulator will order it to reveal information about these products to its competitors. This would be the case even if the disclosure is limited to “interoperability information.” Such a position is misguided.

First, in our case, it is not even clear whether the interface information in question is actually protected by intellectual property. As regards copyright, the remedy does not order disclosure of Microsoft source code. The remedy does not therefore allow rival server vendors to copy any features or functionalities of Microsoft’s PC or server products. Whilst it is true that the document detailing the interfaces which the Commission has ordered Microsoft to produce is a literary work, and hence itself protected by copyright, this is wholly incidental to the remedy. The purpose of the remedy is not to distribute the literary work documenting the interfaces, but to allow rival server vendors to use this information to create their own products which can interoperate with Windows PCs. The point is therefore that the interfaces themselves will not be copied by rival server vendors in their final product. And as I have already said, the remedy does not order disclosure of Microsoft source code, so there is in any case no question of Microsoft’s underlying product being copied.

As regards patents, Microsoft has brought to the Commission's attention several of its patents which it claims would necessarily be infringed by a rival server vendor using the interoperability information that it would be obliged to disclose. As the Commission has not yet had the opportunity to examine the relevant information, I cannot comment in detail on Microsoft's claim. I would nevertheless say that rival server vendors have expressed doubts about whether such Microsoft patents would necessarily be infringed by them when they make interoperable products.

Finally, Microsoft has claimed that the information that it would be forced to disclose is protected by trade secrecy. That the information is secret is clear, since Microsoft has not disclosed it to anyone. However, the first point to make in this regard is that trade secrecy has not been accorded the same level of legal protection as copyright and patents by EU courts. In any case, we have serious doubts about the extent of the innovation behind the secret information. It is therefore likely that the information in question is valuable because it is secret, and not that it is secret because it is valuable in terms of innovation.

Therefore, my first general point is that it is not at all clear that the information that Microsoft is required to disclose by the Decision is protected by intellectual property. However, the Commission's analysis

does not rely on this proposition. In this regard, our point is that even if the information, or some of it, is protected by intellectual property, Microsoft would be obliged to disclose it. Without taking a position on this question, the Decision took the most conservative option, and the one which was most favourable to Microsoft, by assuming that there was indeed intellectual property at stake, and then going through the *Magill/IMS* “hoop” of exceptional circumstances. These exceptional circumstances were as follows:

In the first instance, Microsoft has an overwhelmingly dominant position in the PC operating system market. This means that the interface information in question is indispensable for rival server vendors to be able to compete viably in the market. Without the disclosure of such information, there is a risk that competition in the relevant server market would in time be eliminated.

Secondly, the disclosure of the information in question would allow the development of new products in the relevant server market for which there is a consumer demand, and which are not offered by the dominant company. This is the natural consequence of the type of information that Microsoft is required to disclose. As I have said, competitors will not copy Microsoft’s products, but will be able to develop features in their

own products that will, on the basis of the information that is disclosed, be able to interoperate with Windows PCs.

This leads in naturally to the third question, that of objective justification. It cannot by definition be enough for a dominant company to attempt to justify its refusal to licence intellectual property because of the fact that it is intellectual property. Otherwise, there could never be a case where such a refusal can be contrary to Article 82, whilst the *IMS* judgement explicitly confirms that there can be. The objective justification therefore has to go beyond the mere existence of intellectual property.

In our case, Microsoft attempted to do this. It claimed that disclosure of the information would seriously damage its incentives to innovate. However, when we examined the nature of the information in question, we concluded that this would not be the case. Again, this relates to the nature of the information at stake. In essence, and as I have already highlighted, the information Microsoft is required to disclose is not the core of its product, the source code, but interface information at the edge of its product which describes how other products talk to it. The disclosure of this information would not therefore allow others to copy Microsoft's products, and would not hence reduce its incentives to innovate by allowing rivals to appropriate its innovations. This



consideration applies equally to both the “PC-to-server” and “server-to-server interfaces” that Microsoft is required to disclose under the Decision - there is nothing to suggest that the “server-to-server” interfaces are somehow different in that they reveal more of the underlying product’s source code and way of functioning.

Market practice fully supports this notion. Non-dominant companies routinely disclose interface information to competitors because the value of their product increases if more complementary products can interoperate with it. Indeed, in the past, Microsoft itself, when its server product first entered the market, and when it therefore had incentives to do so, disclosed precisely the same type of information that it is now required to disclose by the Decision. It is only after Microsoft acquired a dominant position in the relevant server market that it refused to disclose the information. It is also important to note that the Software Directive explicitly recognises the value of interoperability in software markets, and, in situations where it is feasible, allows companies to access the interface information necessary to achieve interoperability.

But it is very important to note that not only did we look at Microsoft’s incentives to innovate, but also at the incentives of the market as a whole. Here, we came to the very clear conclusion that Microsoft’s refusal to

disclose the interoperability information was itself reducing the incentives of rivals to bring innovative products to the market. This is because if rivals know that however good their products are, and indeed if they are better than Microsoft's products in terms of reliability, speed, security, new functionalities, and other such factors, they will not be able to compete on the merits simply because Microsoft has reserved for itself an artificial interoperability advantage. Our remedy will therefore increase the degree of innovation in the market - with it, rival server vendors will know that it is worth their while to focus development efforts on innovations in their products since they will now be able to compete on the merits of these products, and without an artificial interoperability obstacle. I should also point out that as rivals' products get better, there will be a spur to Microsoft's own incentives to innovate, as it will no longer be able to simply rely on the artificial interoperability advantage to win in the market.

Let me now turn to examine the second abuse, the tying abuse, and look at it in the same context.

Again, it has been argued by some that the Commission's conclusion that Microsoft's tying of Windows Media Player to Windows was abusive, and the resulting order for Microsoft to untie by offering a version of

Windows without Windows Media Player will have a chilling effect on innovation. Such critics argue that interfering in the design choices of dominant companies is something that a regulator should not do. As a preliminary remark, I would stress that the regulator has a clear duty to act when the design choices, or in this case, the business model, of dominant companies harm competition, and are detrimental to innovation and the consumer.

But let us look at the specifics of the case in a little more detail, and see what general conclusions can be drawn. By way of introduction, I should first stress that the Commission did not follow a *per se* approach to Microsoft's conduct. It followed an approach similar to a "rule of reason." This was the case in two main respects.

Firstly, once it was established that the operating system and the media player were separate products, and that Microsoft offered consumers no choice but to obtain Windows with Windows Media Player, the Commission did not simply presume in a *per se* manner that the conduct was anti-competitive. Instead, the Commission undertook a detailed analysis of the effects of the conduct in the market. We sent extensive questionnaires to content providers and software developers which highlighted the importance that the ubiquity of Windows Media Player,

which results from its tie with Windows, had on their incentives to write to different media platforms. In addition, we analysed a broad range of market data that confirmed that Microsoft's conduct had allowed it to increase its market share, in terms both of media player and media format usage. We also looked at whether this might be because Windows Media Player was of a better quality than rival media players. The range of product reviews in the market indicated that it was not.

The second facet of how we went beyond a *per se* approach was to look at whether there was any objective justification for Microsoft's conduct in terms of plausible efficiencies that derive from tying, and which would benefit the consumer. In this regard, our analysis was similar to the approach decreed by the US Court of Appeals when it remanded the alleged tying by Microsoft of Internet Explorer to Windows to the lower court. In essence, under such an approach, any anti-competitive effects of a tying-type conduct need to be balanced against any efficiencies resulting from this conduct before a pronouncement can be made on whether the conduct is anti-competitive.

What efficiencies, then, did Microsoft claim? Well, I should first stress that throughout the procedure, Microsoft did not claim that there were any technical efficiencies resulting from the tie of Windows Media Player

with Windows. In other words, it did not claim that the integration of the Windows and Windows Media Player code bases led to superior technical product performance. Indeed, all the important innovative steps in the media player market, such as encoding size improvements, streaming, progressive download, and elimination of buffering delays are not at all related to the question of whether a media player is integrated with an operating system.

Instead, Microsoft claimed that there were two types of efficiencies relating to the tying of Windows Media Player with Windows. First, it claimed that there are efficiencies of distribution in terms of lower transaction costs for consumers. In other words, it reduces time and confusion to have a set of default options in a PC “out of the box”. However, this occurs in the market anyway. It is PC manufacturers, who on behalf of consumers, assemble and customise a variety of hardware and software products from different companies for final delivery to the consumer. Therefore, nothing relating to potential transaction efficiencies for consumers requires the tying by Microsoft of its media player to its operating system.

The second type of efficiency claimed by Microsoft relates to the platform nature of its products. In this respect, Windows Media Player is

a platform product in its own right which has applications and content written to it. Microsoft therefore argues that is beneficial for applications developers and content providers to be able to count on the presence of Windows Media Player on all Windows PCs as it saves them programming time and effort and allows them to concentrate on the innovative features of their own products.

There are a number of problems with this line of argumentation. Most importantly, Microsoft's point is not so much an efficiency consideration, but a description of the reason why its tying behaviour is anti-competitive. It is precisely because applications developers and content providers know that they can count on the presence of Windows Media Player on all Windows PCs (and therefore on 95% of all PCs), that there are artificial incentives for them to develop exclusively for this media platform, and which are not related to price and quality. Microsoft's efficiency argument in effect amounts to a plea to have *carte blanche* to be able to extend its Windows monopoly under the guise of maintaining a uniform, non-fragmented platform. I will come back to this point later when I discuss the effects of Microsoft's conduct on the innovation of others.

On the specifics of the efficiency claim, it is clear that to the extent that there might be efficiencies of having a pre-installed bundle of an operating system and a media player, these are not specific to a bundle of Microsoft-only components. Moreover, it is not clear that there are any significant such efficiencies in any case - applications and content are developed separately without any problem for stand-alone media players, including interestingly, Microsoft's own Windows Media Player when it is distributed as an update, or for a non-Windows PC operating system.

So, to summarise, we concluded that Microsoft's tying was abusive because there were demonstrated anti-competitive effects of its conduct which were not at all offset by any justification of plausible efficiencies.

What then of the claim that this conclusion, and the corresponding remedy requirement that Microsoft offers an version of Windows without Windows Media Player, damages its incentives to innovate? Well, in a sense, I have already answered this question. Precisely because the integration of the Windows and Windows Media Player code bases does not lead to superior technical product performance, Microsoft cannot claim that its incentives to innovate have been reduced - nothing in the remedy prevents it from improving either the operating system or the media player.

The purpose of the Decision's remedy is therefore to level the playing field so that competition on the merits can unfold, and that the market outcome is determined by market forces. The remedy is not designed to ensure that one company or another gains a certain amount of media player market share at the expense of Microsoft. In this regard, I should stress that if the media player market is naturally a "winner-take-all" market, the Commission is not opposed to one company winning the battle if this is the natural result of a competitive market process. The Commission therefore recognises that there may be network benefits of standardisation, but if such standardisation occurs, it should be as a result of market forces or work by standards bodies, and should not arise as a result of unilateral extension by a dominant company of its monopoly platform.

This brings me to my next point, which is the effect of Microsoft's conduct, and conversely, the Commission's remedy, on the incentives of others in the market to innovate.

The basic proposition here is simple. As I mentioned earlier, the reason why Microsoft's tying conduct was successful was because it created artificial incentives for applications developers and content providers to



write exclusively to the Windows media platform because of the ubiquity of the Windows Media Player resulting from its tie with Windows. Rival media players cannot therefore compete on the merits on the basis of their quality and price. It is therefore clear that their incentives to innovate in their products, or bring new products to the market, will be reduced if irrespective of how good their product is, they see that it is likely that Windows Media Player will win out simply because it is tied with Windows. The remedy therefore increases the incentives to innovate by removing Microsoft's artificial advantage and restoring the opportunity to compete on the merits. Moreover, as was the case for the interoperability part of the case, there will be a spur to Microsoft's own incentives to innovate, as it will no longer be able to rely on the artificial advantage it derives from tying to win in the market. In fact, the real winners are consumers, who will benefit from greater innovation and choice.

Let me now conclude by asking what the overall lessons that can be drawn from the Microsoft case are. As regards intellectual property licensing, I would like to make three points. Firstly, I should reiterate that the Commission took action in this case because it identified exceptional circumstances. Indeed, it is pretty exceptional that any company has 95% of the market, and can therefore exert such a huge influence on the way that competition unfolds in neighbouring markets. Secondly, I should

recall that the remedy only requires disclosure of interface information necessary for interoperability, and not the underlying core of the product. Thirdly, on the issue of objective justification and incentives to innovate, I can again only stress that our conclusions were the result of an exhaustive analysis of the specific factual circumstances of the case. Taking these three elements together, it is clear that the Commission does not, and cannot apply any kind of *per se* rule to issues of refusal to licence intellectual property. We analyse all cases on their merits, and with a full regard for the legitimate interests of intellectual property holders. Furthermore, we do not go beyond the clear principles that have been established by the European Courts. Companies can therefore be confident that the Commission treads very carefully in such cases, and only intervenes where the survival of meaningful competition in a particular market is at risk.

The very same considerations apply to the question of product integration or tying. Let me again make very clear that our conclusions were the result of an exhaustive analysis of the specific factual circumstances of the case, including an examination of the possible benefits of Microsoft's conduct. There is therefore no question of there being some kind of general *per se* rule or ban, even for Microsoft, relating to products that it cannot integrate with Windows. The Commission would only therefore

seek to intervene in cases where the conduct in question has clear anti-competitive effects, and where there are no significant plausible efficiency explanations for the tie. Even if the Commission intervenes, it leaves the choice between the integrated and non-integrated version to the market. By taking this overall balanced approach, we preserve both the interests and incentives of the dominant company to improve its product, but also ensure that innovation in the market to the benefit of the consumer can come from other players.

Thank you.