



EUROPEAN COMMISSION

Cabinet of Mario MONTI

Brussels, 15-03-2004
COMP/C-3/JHU D(2004)

**DECISION OF THE COMMISSION RELATING TO A PROCEDURE
PURSUANT TO ARTICLE 82 OF THE EC TREATY**

**CASE COMP/C3-37.792 – MICROSOFT
(ONLY THE ENGLISH TEXT IS AUTHENTIC)**

COMMUNICATION FROM MR MONTI TO MEMBERS OF THE COMMISSION

I

The subject of the present procedure is the adoption of a Commission Decision pursuant to Article 82 of the EC Treaty. The Decision holds that Microsoft *abuses its dominant position* in the market for operating systems for client personal computers ("client PCs") in violation of Article 82 of the EC Treaty and Article 54 of the EEA Agreement in two ways. On the one hand, Microsoft refuses to provide its competitors with interoperability information which is indispensable for them to be able to viably compete in the work group server operating system market. On the other hand, Microsoft illegally ties its streaming media player (Windows Media Player) with its dominant client PC operating system.

The Report of the Hearing Officer notes that the rights of defence of Microsoft as well as the rights of third parties have been respected.

The Advisory Committee on Restrictive Practices and Dominant Positions has unanimously approved the Decision.

A fine is foreseen in the text of the Decision and the Decision sets out the reasoning for the proposed amount.

II

A. IMPORTANCE OF THE CASE FOR COMPETITION POLICY

The Decision concerns markets of great economic importance and potential, on which Microsoft's abuse of its dominant position has a strong anti-competitive impact.

Work group server operating systems are the software products that control servers which are used by most office workers around the world to securely share and print files. Microsoft's refusal to supply risks eliminating competition in that market. Dominating this area provides Microsoft with a bridgehead which it can then leverage further into the server industry.

Streaming media players are a key element in the delivery of digital content over the Internet. Microsoft abusively ties its streaming media player, Windows Media Player ("WMP") with Windows, thereby distorting competition in the market for these products. Microsoft's tying enables it to take advantage of its market power to impose its proprietary digital media architecture, to the detriment of competition on the merits. This has spill-over effects in many emerging markets related to digital media.

Both abuses enable Microsoft to protect an overwhelming dominant position, verging on the monopoly, in the client PC operating system.

From a legal perspective, the Decision will play an important role in clarifying the Commission's position vis-à-vis certain practices in the software industry.

As regards the refusal to supply abuse, the Decision reaffirms the importance of interoperability for competition and innovation in IT markets, which was already present in the hallmark IBM case in the early 1980s and plays a key role in Community law, in particular in Council Directive 91/250/EEC of 14 May 1991 on the legal protection of computer programs (the "Software Directive"). The Decision strikes a careful balance between the need to ensure competition and follow-on innovation and the need to safeguard Microsoft's intellectual property rights. This is necessary, since Microsoft has provided *prima facie* evidence that the Decision will limit its right to refuse to license such rights for the purpose of ensuring interoperability. In this respect, the Decision, in line with the Court's case law, reaffirms that in circumstances of an exceptional nature, as are the ones established in the present case, a refusal to license intellectual property may constitute abusive conduct prohibited by Article 82.

As regards the tying abuse, the Decision will provide guidance in the future to address allegations of tying in software markets that involve technical integration.

More generally, the Decision will constitute an extremely important precedent as regards how Article 82 is applied in new technology markets. It stresses in particular the need for strong antitrust policy in order to prevent the lock-in of consumers into proprietary solutions through abuse of market power.

This precedent value will be important, not least *vis-à-vis* Microsoft itself. It must indeed be noted that a number of third parties have already submitted a number of complaints alleging that Microsoft is pursuing strategies similar to the ones described in this Decision in a number of other areas. The present Decision will send a clear signal to

Microsoft with respect to its responsibility as a dominant company and provide a methodology to address the various new allegations of anti-competitive conduct that have already been put forward or will be put forward to the Commission with respect to this company.

B. PROCEDURE

10 December 1998	Complaint by Sun Microsystems (Case IV/C-3/37.345)
1 August 2000	First Statement of Objections
17 November 2000	Reply by Microsoft
30 August 2001	Second Statement of Objections (this Statement of Objections joins the findings in case IV/C-3/37.345 to case COMP/C-3/37.792, and closes case IV/C-3/37.345)
16 November 2001	Reply by Microsoft
6 August 2003	Supplementary Statement of Objections
17 October 2003	Reply by Microsoft
31 October 2003	Complement to Microsoft's reply
12-14 November 2003	Oral Hearing
16 January 2004	Letter sent to Microsoft following the fifth access to file
7 February 2004	Reply by Microsoft to the letter dated 16 January 2004

C. BRIEF OVERVIEW OF THE CASE

The relevant markets

The Decision defines three relevant product markets.

The first market defined is that for *client PC operating systems*. Operating systems are software products that control the basic functions of a computer and enable the user to make use of such a computer and run application software on it. "Client PCs" are general-purpose computers designed for use by one person at a time and able to connect to a network. The question of whether non-Intel compatible products should be excluded from the market is left open, since including them would have no significant impact on the assessment of Microsoft's market power.

The second market is that for *work group server operating systems*. The Decision defines "work group server services" as the basic infrastructure services that are used by office workers in their day-to-day work, namely: sharing files stored on servers, sharing printers, and the "administration" of how users and groups of users can access network services ("group and user administration"). "Work group server operating systems" are

operating systems designed and marketed to deliver these services collectively to relatively small numbers of client PCs connected to small to medium-sized networks.

As regards this second market, from a demand side perspective, the Commission has in particular examined the tasks performed by different server operating systems. Market evidence confirms that consumers view work group server services as “going together”. Other server operating systems which run on enterprise servers supporting mission-critical applications or “edge servers” that sit at the edge of the work group network fulfil a different consumer demand. In addition to work group server operating systems, Microsoft offers other server operating systems targeted at different demands, for which it charges prices significantly different to the prices that it charges for its work group server operating systems. The investigation also shows that interoperability with the client PC is a key purchasing criterion for work group server operating systems. As regards supply side substitutability, in order to compete more intensely in the work group server operating system market, a vendor who has a marginal presence there – or no presence at all – would have to substantially modify its products to adapt them to the particular tasks that are specific to that market. The investment and time required to do so are beyond what is relevant to consider supply-side substitution at the market definition stage. The market for work group server operating systems exhibits indirect network effects that translate into barriers to entry.

A third market defined by the Decision is that for *streaming media players*. A “media player” is a software product that is essentially able to “play back” audio and video content encoded in digital form, i.e. to understand that digital content and translate it into instructions for the hardware (such as loudspeakers or a display). Streaming media players are able to render content “streamed” across the Internet: instead of waiting for an entire audio or video file to download, the file is sent to the client PC as a sequence of small pieces, i.e. as a “stream” of data that the media player plays as it goes along. It must be noted that only media players capable of streaming exert competitive constraints on WMP and that the market for streaming media players exhibits indirect network effects that translate into barriers to entry.

The geographic scope of all three relevant markets outlined above is world-wide.

The dominant position

There are two abuses identified in the Decision, which both have their origin in Microsoft’s dominant position in the client PC operating system market. Microsoft agrees with this finding of dominance by the Commission. It must be noted that this dominant position is characterised *inter alia* by very high market shares (above 90%) and high barriers to entry due to indirect network effects (“applications barrier to entry”). It is established that Microsoft has been enjoying this dominant position, verging on monopoly, since at least 1996.

Abuses

The Decision identifies two distinct abusive behaviours: the refusal to supply interoperability information and the tying of Windows Media Player to Windows.

Refusal to supply interoperability information

The Decision establishes that the complainant Sun has clearly expressed its interest in receiving certain interoperability information which Microsoft has refused to provide. This is evidenced by a letter from Sun Vice President Richard Green to Microsoft Vice President Paul Maritz of 15 September 1998 and Mr. Maritz's response of 4 October 1998. The interoperability information refused to Sun pertains to Microsoft's "Active Directory domain architecture", a set of interrelated protocols which organise communication in networks of Windows client PCs and Windows work group servers. Although the refusal at issue relates to both client-server and server-server protocols in the Active Directory domain architecture, its competitive significance derives from Microsoft's dominant position in the client PC operating system market. Furthermore, it must be noted that the refusal is part of a disruption of previous levels of supply, since similar information for previous generations of Microsoft's products had been indirectly available to Sun through a licensing agreement between Microsoft and AT&T. Finally, Microsoft's refusal to Sun is part of a general pattern of conduct *vis-à-vis* all actual or potential work group server operating system vendors: Sun is not the only undertaking to have asked for interoperability information from Microsoft and to not have received it.

It must be underlined that the refusal at issue in this case is not a refusal to supply source code, but specifications for the relevant protocols. However, Microsoft argues that disclosing the requested interoperability information and allowing Sun to make use of it to build interoperable products would involve licensing to Sun some of Microsoft's intellectual property rights. The Decision does not exclude that Microsoft's intellectual property-related claims are accurate.

According to the jurisprudence of the Court of Justice, however, in exceptional circumstances, a refusal to supply by a dominant firm, even when it is a refusal to license intellectual property rights, may constitute an abuse, unless it is objectively justified. The Decision concludes that the circumstances present in the present case are of such an exceptional nature.

First, the Decision establishes that Microsoft's refusal risks eliminating competition in the work group server operating system market and that this risk of elimination of competition is due to the indispensability of the refused input. In this respect, the evolution of the various market positions in the work group server operating system market shows that Microsoft is progressively ousting incumbents such as Novell, and keeping at bay potential new entrants such as Linux. The link with the advantage that Microsoft derives from reserving to itself crucial interoperability information is confirmed in particular by evidence gathered by the Commission. Far from rebutting the Commission's analysis in the Statements of Objections in this respect, survey responses submitted by Microsoft provide further evidence of the causal link between this interoperability advantage and Microsoft's market success. The Decision also deals with the allegation by Microsoft that there are actual or potential substitutes to disclosure of interoperability information and concludes that there are technical and economic obstacles that render the substitutes put forward by Microsoft inadequate.

Second, Microsoft's behaviour has the impact of limiting technical development to the prejudice of consumers. In particular, by securing for itself an interoperability premium through the withholding of technical information, Microsoft ensures that other product characteristics such as reliability, security and speed are relegated to a secondary position. This stifles innovation in these areas, which, as evidenced by the surveys submitted by Microsoft itself, are dear to consumers' interests.

The most important justification put forward by Microsoft relates to its intellectual property over Windows. In view of the exceptional circumstances outlined above (risk of elimination of competition, anti-competitive behaviour that has an impact manifestly contrary to the aims of Article 82), this cannot in itself constitute an objective justification. Moreover, a detailed examination of the scope of the order to supply at stake leads to the conclusion that, on balance, the alleged negative impact of such an order to supply on Microsoft's incentives to innovate is outweighed by its positive impact on the level of innovation of the whole industry. The Decision deals *in extenso* with that point, and has regard to the approach taken by the Community legislator in the Software Directive.

Microsoft's behaviour amounts to an infringement of Article 82 from 4 October 1998 onward, which corresponds to the date of Microsoft's response to Sun's request.

Tying

Tying prohibited under Article 82 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 affords consumers no choice to source the tying product without the tied product; and (iv) tying harms competition.

Client PC operating systems and media players are *separate products*. This is shown on the basis of various elements: (i) the existence of separate consumer demand for media players, distinguishable from demand for client PC operating systems; (ii) the existence of vendors who develop and supply media players on a stand-alone basis; and (iii) Microsoft's own practice of developing and distributing versions of WMP for other client PC operating system products.

Microsoft is *dominant* in the market for client PC operating systems.

Since the launch of Windows 98 Second Edition in May 1999, Microsoft has been distributing Windows (the "tying" product) only together with WMP (the "tied" product) and does not allow for the removal of the WMP code. Original Equipment Manufacturers ("OEMs") and consumers are therefore left *no choice* to obtain Windows without WMP. There is no language in Article 82 which would require, as suggested by Microsoft, that customers actually pay for the bundled product or are forced to use it. Article 82 applies to conduct which indirectly ties customers, thereby giving rise to exclusionary effects comparable to those stemming from "direct" tying.

As regards the fourth element of *harm to competition*, the Commission has taken account of the particularities of the case, and in particular of the fact that users can and do also obtain other media players (mainly over the Internet) and that, in certain cases, these media players are distributed for free. Therefore, although in previous tying cases, the Commission and the Court have usually considered the foreclosure effect for competing vendors to be demonstrated by the bundling of a separate product with the dominant product, in this case the Commission has undertaken a detailed analysis of the impact of Microsoft's behaviour.

Due to tying, WMP instantly shares the ubiquity of Windows in newly-shipped client PCs. Other distribution means (e.g. downloading over the Internet, bundling with other software or hardware, agreements with OEMs and the retail channel) are second best.

This guarantees content providers and software developers that, if they use Microsoft's technology, they will be able to reach virtually all client PC users world-wide. Furthermore, market evidence gathered by the Commission shows that supporting several

technologies generates significant additional costs. As such, WMP's ubiquitous presence induces content providers and software developers to rely on Windows Media technology. Due to the fact that applications and content are largely specific to the underlying technology used, customers will in turn prefer using WMP, since a wider array of complementary software and content will be available for that product.

This self-reinforcing mechanism impairs the competitive process in the media player market and has spill-over effects on competition in other markets. For instance, it strengthens Microsoft's position on media encoding and management software (often server-side). Furthermore, if Microsoft came to control the media player market, keeping its Windows Media technology proprietary could constitute a significant barrier to market entry, not only to the media player market but also to related markets in which streaming media technologies are used (e.g. handheld devices), and to the client PC operating system market.

Market data show a clear trend in favour of usage of WMP and Windows Media technology, to the detriment of competing solutions. Microsoft's argument that its success is the result of competition on the merits is not supported by the available evidence, which does not point to a clear-cut lead of WMP in terms of product quality.

Microsoft attempts to justify its conduct by putting forward a number of efficiency considerations related to distribution and to the protection of the coherence of the Windows platform. However, Microsoft has not demonstrated to the requisite legal standard that its tying behaviour was indispensable to bring about the claimed efficiencies.

In conclusion, Microsoft's tying of WMP with Windows violates Article 82, in particular paragraph (d) thereof.

The abuse started with the Windows 98 Second Edition in May 1999, which is the starting point for the tying practice.

Remedies

The Decision orders Microsoft to bring the abuses to an end and to refrain from engaging in conduct having an equivalent effect.

As regards interoperability, Microsoft would, within 120 days of the date of notification of the Decision, disclose complete and accurate specifications for the protocols used by Windows work group server operating systems in order to provide file, print and group and user administration services to Windows work group networks. This includes both direct interconnection and interaction between a Windows work group server operating systems and a Windows client PC operating system, as well as interconnection and interaction between a Windows work group server operating system and a Windows client PC operating system that is indirect and passes through another Windows work group server operating system. Microsoft must allow the use of the disclosed specifications for implementation in work group server operating system products. In any event, to the extent that the remedy thereby limits Microsoft's exercise of certain intellectual property rights, this is justified by the need to put an end to the abuse. The Decision requires Microsoft to disclose the specifications and allow the use thereof under reasonable and non-discriminatory terms. Within 60 days of the date of notification of the Decision, Microsoft would submit to the Commission a detailed outline of the measures that it intends to take in order to comply.

As regards tying, Microsoft would, within 90 days of the day of notification of the Decision, have to offer a version of its Windows client PC operating system product that does not include WMP. However, it would retain the right to offer a version of its Windows client PC operating system product with WMP.

The Commission considers that the effective oversight of Microsoft's compliance with the Decision would be optimised by the appointment of a monitoring trustee. The Decision therefore requires Microsoft to submit a proposal to that effect and provides guiding principles for Microsoft to draft its proposal.

The Decision is consistent with the Community's international obligations, in particular the TRIPS and TBT agreements. Microsoft's argument that this cannot be the case must be rejected. In any event, Microsoft could not invoke the WTO rules to challenge the legality of the Decision.¹

D. FINES

Given the above, a fine should be imposed on Microsoft. The fine must be determined in light of the gravity and duration of the infringement (the only criteria set out in Article 15, paragraph 2 of Regulation 17) and in line with the Commission *Guidelines on the method of setting fines*². The reasoning for imposing a fine in this case is set out as follows.

Gravity of the infringement

In determining the gravity of the infringement, the Commission must consider its nature, its concrete impact on the market, and the size of the affected market.

Regarding the nature of the abuse, Microsoft deliberately abuses a dominant position verging on monopoly in the client PC operating system market by trying to extend it, by different means, to the work group server operating system market and to the streaming media player market.

As regards the refusal to supply abuse, Microsoft's refusal to Sun is part of a general pattern of conduct which focuses on the creation and sole exploitation of a range of privileged connections between its dominant client PC operating system and its work group server operating system, and on the disruption of previous levels of interoperability. This conduct impacts the process of competition in the work group server operating system market, which is a market of significant value in its own right, as

¹ Indeed, it is settled case-law that "*having regard to their nature and structure, the WTO agreements are not in principle among the rules in the light of which the Court is to review the legality of measures adopted by the Community institutions*". See Judgement of the Court in Case C-149/96 *Portugal v Council* [1999] ECR I-8395, at paragraph 47; confirmed for the TRIPS Agreement in Judgment of the Court in Case C-491/01, *British American Tobacco* [2002] ECR I-11453, at paragraphs 154-156). It also follows from this case-law that "[i]t is only where the Community intended to implement a particular obligation assumed in the context of the WTO, or where the Community measure refers expressly to the precise provisions of the WTO agreements, that it is for the Court to review the legality of the Community measure in question in the light of the WTO rules". See Judgement of the Court in Case C-149/96 *Portugal v Council* [1999] ECR I-8395, at paragraph 49.

² Guidelines on the method of setting fines imposed pursuant to Article 15 (2) of Regulation No 17 and Article 65 (5) of the ECSC Treaty, OJ C 009/3 of, 14/01/1998

well as a bridgehead to other areas of the server industry. It also strengthens the barriers to entry that protect Microsoft's dominance in the client PC operating system market.

As regards the tying abuse, Microsoft ties the sale of its ubiquitous client PC operating system product to that of WMP, thereby securing for the latter product an advantage over other streaming media player, to the detriment of competition on the merits. The ensuing distortion of competition in the market for streaming media players has spill-over effects on several areas of the digital media industry. Microsoft's tying practice also has the effect of strengthening the barriers to entry in the client PC operating system market.

The impact of the abuses is significant. As regards the market for work group server operating systems, the abuse risks eliminating competition, and has in fact already enabled Microsoft to achieve a dominant position. As regard the market for streaming media players, the ubiquitous presence of WMP has generated a clear-cut evolution in favour of WMP, which has now achieved a leading position in that market. Evidence gathered in the course of the investigation suggests that the market may already be tipping in favour of WMP.

For the purposes of assessing the gravity of the abuses (with regard to the fine), the markets for client PC operating systems, for work group server operating systems and for media players, are EEA-wide in scope.

On the basis of these criteria and the guidelines, the infringement must be considered as "very serious".

Duration

For the purposes of the calculation of the fine, the duration of Microsoft's infringement is 5 years and 5 months.

Aggravating and mitigating circumstances

There are no aggravating or attenuating circumstances relevant to the Decision.

III

It is therefore proposed that the Commission:

- Takes note of the unanimous favourable opinion of the Advisory Committee on Restrictive Practices and Dominant Positions;
- Takes note of the Final Report of the Hearing Officer;
- Adopts the attached Decision in annex; only the English version is authentic;
- Publishes the most important parts of the attached Decision in the L series of the Official Journal of the European Communities in all official languages and makes the Decision available on the Internet.

Annexes: Draft Decision in case COMP/C3/37.792 – Microsoft
Opinion of the Legal Service
Opinion of the Advisory Committee of 15 March 2004
Final Report of the Hearing Officer