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THE SECRET ART OF MAGIC ?

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TYING LAW IN *MICROSOFT I* AND *II* – THE SECRET ART OF MAGIC?

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This paper seeks to uncover an inconvenient truth. The *Microsoft* decisions are not tying cases. Rather, the two decisions taken by the EU Commission against Microsoft – *i.e.* the Windows Media Player (“*WMP*”) case of 2004 and the Internet Explorer (“*IE*”) case of 2009 – mark departures from conventional tying analysis (I).¹ First, they deviate from standard tying law in that in the *Microsoft* cases, a key component of abusive tying, namely coercion, is missing (II). Second, the *Microsoft* decisions share many analogies with “*essential facility*” cases. One may thus question to what extent the Commission has not pursued disguised refusal to supply cases (III).

Of course, our point that the *Microsoft* decisions are not conventional tying cases may be criticized as overly theoretical. However, we believe that our argument has very significant practical consequences. Thus far, the Commission’s decisions in *Microsoft I* and *II* constitute the latest authoritative case-law on tying.² Therefore, and assuming our argument is valid, the scope of tying infringements under EU competition law may have dramatically, and perhaps overly, increased following those decisions (which were upheld by the General Court (“GC”).³

I. Overview of the *Microsoft* Cases

In a classic tying theory of harm, a dominant firm in market A leverages its market position to market B, by subordinating the sale of A to the purchase of B. According to the case-law of the European Court of Justice (“ECJ”) and the GC, as well as to the Commission’s recent Guidance

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¹ Commission Decision of 24 March 2004 relating to a proceeding under Article 82 of the EC Treaty (Case COMP/C-3/37.792 Microsoft) [hereinafter “Media Player Decision”]; Commission decision of 16.12.2009 relating to a proceeding under Article 102 of the Treaty on the Functioning of the European Union and Article 54 of the EEA Agreement (Case COMP/C-3/39.530 – Microsoft (tying)) [hereinafter “Internet Explorer Decision”].

² While the Guidance Communication issued by the Commission is not a statement of the law. See Guidance on the Commission’s Enforcement Priorities in Applying Article 82 EC Treaty to Abusive Exclusionary Conduct by Dominant Undertakings, 3 December 2008, COM(2008), 26 p.

³ GC, 17 Sept. 2007, T-201/04, Microsoft v. Commission, *E.C.R.*, 2007, p. II-03601.

Communication on Article 102 TFEU, tying may be akin to an unlawful abuse under Article 102 TFEU provided three conditions are met: (i) the firm under scrutiny is dominant on the market for the tying product; (ii) the tying and the tied products are two separate products; and (iii) the tying practice forecloses competition.⁴

The EU *Microsoft* saga dates back to 2004, when the Commission found that Microsoft had unlawfully tied its Operating System (“OS”) Windows with WMP. This decision ordered Microsoft to supply a naked version of Windows, stripped-down from WMP. *Ex post facto*, the performance of the remedy imposed by the Commission has triggered controversy. No original equipment manufacturer (“OEM”) in the world chose to install the naked version of Windows. Retailers bought less than 2000 copies of it.⁵ Ironically, it was suggested that those copies may have been bought by IT geeks willing to have a copy of the first software ever designed by DG COMP.⁶

In 2009, the Commission stroke again. It opened infringement proceedings against Microsoft, this time in relation to the tying of IE with Windows. Albeit similar in nature to *Microsoft I*, the main feature of this case is that Microsoft offered commitments, and the Commission closed the procedure. First, Microsoft undertook to enable users and OEMS to turn IE off and on. Second, Microsoft undertook to display a ballot screen to IE users (via Windows Update), with a view to give them an opportunity to install one of the 12 browsers with the largest usage share.⁷ The effectiveness of those remedies remains a bone of contention. Recently, the *New York Times* indicated that those remedies had barely affected browsers markets.⁸ In contrast, others argue that Microsoft’s market share in the web browser market is gradually falling, as a result of the ballot screen remedy.⁹

⁴ Guidance on the Commission’s Enforcement Priorities in Applying Article 82 EC *op. cit.*, p. 22, para. 50.

⁵ 1.787 exactly. This represented less than 0.005 percent of the copies of all retail sales of Windows XP in Europe (results for the period between the offering of the naked version of Windows and the time of the hearing before the GC). C. AHLBORN and S. EVANS, “The Microsoft Judgment and its Implications for Competition Policy towards Dominant Firms in Europe”, *Antitrust Law Journal*, 2009, Vol. 75, No. 3, (available at: www.ssrn.com) p. 24.

⁶ *Microsoft Begins Defense of Self Against EU*, April 24, 2006, Ed Sutherland, www.internetnews.com.

⁷ Internet Explorer Decision, *op. cit.*, para. 60.

⁸ K. O'BRIEN, “European Antitrust Deal With Microsoft Barely Affects Browser Market”, *New York Times*, 10 October 2010.

⁹ In Europe, IE market share fell to 40.26% in September this year from 46.44% in September last year. *StatCounter*, “Microsoft’s Internet Explorer browser falls below 50% of worldwide market for first time”, 5 October 2010, (available at: <http://gs.statcounter.com/press/microsoft-internet-explorer-browser-falls-below-50-perc-of-worldwide-market-for-first-time>). N. FARREL, “Microsoft IE loses more market share. March of the Firefox”, *TechEye*, 22 March 2010 (available at: <http://www.techeye.net/software/microsoft-ie-loses-more-market-share>).

II. The Microsoft Cases involve no Coercion of Customers

In both the US and the EU, a key, standard feature of tying cases is that customers are “*coerced*” (or forced) to purchase the tied product.¹⁰ Put simply, coercion arises if the sale of the tying product is conditioned on the purchase of the tied product. The problem with coercion is twofold. First, coercion may lead a customer to acquire supplementary products/services which it does not need at all. For instance, a customer that enjoys his own transport means may be forced to purchase bus transportation services to the airport when booking a flight ticket. There is here an “*exploitation*” problem.

Second, coercion may restrict a customer’s freedom of choice amongst supplementary products/services which it needs to acquire.¹¹ With coercion, the customer is automatically directed to, or locked in, the dominant firm’s tied product/service at the expense of rival products/services. There is here an “*exclusion*” problem. Customers who must take the dominant firm tied products/services forego resources (money, space, other) which could be invested in alternative products/services. In *Hilti*, the Commission sanctioned the tying of cartridge strips with nails.¹² Customers that had acquired the dominant firm’s tied nails were held to have foregone their freedom of choice regarding the source of their nails which, in turn, excluded independent nail makers.¹³ Importantly, this type of coercion can only arise if the tied product is

¹⁰ Absent any such tie, standard economic theory predicts that consumers will turn to competitive products. Coercion may take the form of a physical tie (a common packaging) or of an economic tie (a rebate on the purchase of the two products).

¹¹ The rulings of the EU courts in *Hoffmann La Roche* and *Hilti* cast light on this issue. The judgments of the Community courts are replete with references to the fact that coercion entails a restriction of customers’ freedom of choice. In *Hoffmann La Roche*, for instance, the ECJ held that the dominant firm tied its customer in a way to “[d]eprive the purchaser or restrict his possible choice of sources of supply and to deny other products access to the market” (ECJ, 13 February 1979, Case 85/76, *Hoffmann-La Roche v Commission*, *ECR*, 1979, p. 461, para. 60). The Commission reached a similar finding in *Hilti*, where it concluded that tying the sale of cartridge strips to the sale of nails constituted an unlawful abuse because customers that had acquired the dominant firms nails, had irremediably foregone their freedom of choice regarding the source of their nails which, in turn, excluded independent nail makers (Commission Decision of 22 December 1987 (IV/30.787 and 31.488 - Eurofix-Bauco v. Hilti), *OJ*, 11 March 1988, L 65/19, para. 75).

¹² Commission Decision of 22 December 1987 (IV/30.787 and 31.488 - Eurofix-Bauco v. Hilti), *supra*.

¹³ This assumes that all consumers needs are fulfilled. Otherwise, rival operators would be able to compete for that portion of the market where consumers still exercise their freedom of choice and, hence, would not be excluded. For instance, the *Van den Bergh Foods* ruling seems to imply – *a contrario* – that a 6% foreclosure would have been *de minimis*. GC, 23 October 2003, *Van den Bergh Foods Ltd v Commission*, T-65/98, *ECR*, 2003, p. II-04653.

a “*rivalrous good*” or, in other words, a product whose acquisition prevents/limits the acquisition of other, substitutable, products (notably those of rivals)¹⁴.

In its two *Microsoft* decisions, the Commission contended that Microsoft had coerced customers.¹⁵ However, on the facts, this allegation seems disputable. In those cases, there was no coercion, because media players and Internet browsers are non-rivalrous goods which are distributed for free.¹⁶ Due to the possibility of “*multi-homing*”, i.e. the ability for customers, to acquire, install and use several Internet browsers/media players on a single PC,¹⁷ customer’s freedom of choice was wholly preserved. In addition, from a technical perspective, the limited file size of most Internet browsers and media players, as well as the development of “*cloud computing*” meant that the share of hard disk memory devoted to additional softwares became increasingly trivial.

Finally, the so-called “*positive feedback loop*” which had arguably created a network effect contributing to “guide” consumers towards Microsoft in the *WMP* case, was clearly absent from the *IE* case.¹⁸

¹⁴ We slightly stretch the classic definition of what a rivalrous good is here. Traditionally, rivalry relates to a situation where “*Everyone technically can use the good, but the use of the good by one person detracts from the ability of others to enjoy the good*”. (J. TAYLOR and A. WEERAPANA, *Economics*, South-Western College Pub, 6th ed., 2009, p. 435). We shift from a situation where the use of one good limits the ability of another person to use that same good, to a situation where the use of one good limits the ability of that same user to use another good.

¹⁵ The decision indicates that “*customers are not given a choice*” because Microsoft softwares come “*pre-installed*” with Windows and cannot “*be un-installed*”. Hence, the Commission found that the third constituent element of illegal tying pursuant to Article 102 TFEU – i.e. the fact that “*the conclusion of contracts is made subject to the acceptance of supplementary obligations*” – would be met. GC, 17 Sept. 2007, *op. cit.*, para. 827.

¹⁶ On its side, the Commission stated that no monetary sacrifice was required for a tying abuse to be proven as “*the wording of paragraph (d) of Article 82 does not include a reference to “paying” when introducing the element of a “supplemental” obligation*”. (Media Player Decision, *op. cit.*, para. 831). This brings some perspective with the GC’s odd assertion that consumers had to pay for WMP an extra fee included in the total price of the Windows OS, GC, 17 Sept. 2007, T-201/04, *Microsoft v. Commission*, *op. cit.*, para. 967-968.

¹⁷ J. TIROLE, “The Analysis of Tying Cases: A Primer”, *Competition Policy International*, Vol 1. Number 1, Spring 2005, at p.12: “[I]n a two-sided market in which the cost of multi-homing for users facing the tie is small, the tie on that side of the market need not preclude competitors from profitably competing, even when competitors’ technology is undifferentiated from the tied technology from their point of view”. See also J. GABSZEWICZ and X. WAUTHY, *Two-Sided Markets and Price Competition with Multi-homing*, Université Catholique de Louvain, 2004, *mimeo*. In a multi-homing market, there is a priori no reason why a buyer should choose to acquire a single product only, at the exclusion of the other.

¹⁸ In the *WMP* case, the Commission took concern that content providers had a compelling economic incentive to code their products within Microsoft’s proprietary music format (WMA) in order to reach a majority of PC users, which in turn reinforced the popularity of that platform with users. By contrast, *IE* does not entail the support of a Microsoft proprietary format. Rather, *IE* supports a collection of *industry* standard. Hence, the allegations of the Commission that a positive feedback loop would contribute to push consumers towards *IE* is inappropriate. See Internet Explorer Decision, *op. cit.*, para. 55.

Of course, one may argue that rather than end-users, Microsoft had coerced OEMs to purchase WMP and IE. Yet again, OEMs were not subject to any sort of technical coercion given that Windows worked perfectly with rival Internet browsers and media players. Second, there was no contractual coercion, because OEMs remained free to change the default settings on PCs, and install rival softwares.

Absent clear-cut coercion, the *Microsoft* decisions thus depart from conventional tying law. On closer examination, they show how behavioural economics can be used to fabricate novel theories of harm. Behavioral economics indeed suggests that dominant firms may leverage market power absent coercion, simply by exploiting customers' biases.¹⁹ In the *Microsoft* decisions, the Commission found that the pre-installation of WMP and IE on Windows was conducive to leveraging because of "*end-users inertia*". The Commission explained that users did not switch to rival softwares through downloading. This was due to barriers such as searching, choosing and installing a competing software, which could stem from a lack of technical skills.²⁰ In *Microsoft II*, the Commission relied on empirical analyses to confirm its findings. A consumer survey showed that a majority of users (51%) had not downloaded alternative browsers.

Such factual findings would in themselves, deserve lengthy discussions, notably on the risks of errors due to "*framing*" issues when conducting empirical surveys (in other words, the way a question is asked)²¹ and on the risk to witness behavioural economics backfire against competition authorities with firms challenging the partiality of the surveys ordered before Courts. That said, on a more principled level, the Commission's manifest interest in behavioural theories of harm raises a more fundamental issue which, in the lawyer's jargon can be referred to as an *imputability* issue (or, in the economists' jargon an *identification* problem).²² In essence,

¹⁹ M. BENETT, J. FINGLETON, A. FLETCHER, L. HURLEY and D. RUCK, "What Does Behavioral Economics Mean for Competition Policy ?", *Competition Policy International*, Spring 2010, vol 6, n°1, p. 121 : "*Behavioral economics suggests that even small switching costs can have significant effects on consumer behavior in the presence of consumer inertia, endowment effects, and default bias. This can, in turn, make foreclosure more likely to occur through tying and bundling.*" According to behavioral economics, dominant firms may also leverage market power absent coercion, simply by exploiting customers' intrinsic biases, such as inertia, hassle costs, availability heuristics and risk aversion.

²⁰ Media Player Decision, *op. cit.*, para. 866, 869 and 870; Internet Explorer Decision, *op. cit.*, para. 48.

²¹ People provide different answers when the same questions are presented in different ways. See A. TVERSKY & D. KAHNEMAN, "The Framing of Decisions and the Psychology of Choice", *Science*, Vol. 211, No. 4481, p. 453; M. SALINGER, "Behavioral economics, consumer protection and antitrust", *Competition Policy International*, Vol. 6, n°1, Spring 2010, p. 71.

²² On legal grounds, competition rules target firms' misconduct in the market place.

the nub of the *Microsoft* cases is not so much about a dominant firm seeking to abusively coerce customers, but rather about its customers' inability to make optimal choices because of intrinsic biases. Hence, one may question whether it is suitable to lay the blame exclusively on the dominant firm – through Article 102 TFEU infringement and commitments decisions, administrative fines, intrusive regulatory takings and possible follow-on actions – whilst the core of the market failure originates on the customers' side. By way of comparison, in other concentrated sectors such as retail banking, where the degree of competition is weak due to consumers switching rigidities, competition authorities have cautiously refrained from blaming companies on the basis of the competition rules. Rather, other instruments (such as consumer law) are used to foster the mobility of retail banking customers.²³

III. The *Microsoft* Cases are Disguised Refusal to Supply Cases

Besides this, there is another good sense in which the *Microsoft* decisions do not constitute abusive tying cases. In both cases,²⁴ the crux of the matter lied in reality in the fact that Windows constituted a key platform for the distribution of software to customers. The wording of the Commission's decisions is devoid of ambiguity. The Commission took concern with the fact that “*Microsoft controls the distribution of Internet Explorer with Windows and does not afford competing web browser vendors access to that mode of distribution.*”²⁵ In other words, in refusing to grant access to its OS to rival softwares, Microsoft would have unlawfully foreclosed competitors. The “*must carry*” remedy imposed in *Microsoft II* further confirms this interpretation²⁶.

With this in mind, one may then question why the Commission found necessary to build tying cases, rather than using the traditional “*essential facility*” route. On cursory analysis, there are a

²³ If nudging customers may be the sole solution to open markets, consumer law may be a more appropriate tool than competition law to achieve that aim. See E. GARCÉS, “The Impact of Behavioral Economics on Consumer and Competition Policies”, *Competition Policy International*, Spring 2010, Vol. 6, N°1, p. 150, which stresses that remedial interventions may generate inefficiencies.

²⁴ In the *WMP* case already, the competition issue related to the privileged distribution channel that Microsoft enjoyed thanks to Windows. See Media Player Decision, *op. cit.*, para. 844-849. See also J.-Y. ART and G. McCURDY, “The European Commission's media player remedy in its Microsoft decision: compulsory code removal despite the absence of tying or foreclosure”, *E.C.L.R.*, 25(11), 2004, p. 696.

²⁵ Internet Explorer Decision, *op. cit.*, para. 40.

²⁶ N. ECONOMIDES and I. LIANOS, “A Critical Appraisal of Remedies in the EU Microsoft Cases”, *Columbia Business Law Review*, Vol. 2010, N° 2, p. 389 (available at: www.ssrn.com).

variety of plausible factual and historical reasons for this.²⁷ However, we believe that the Commission may have been reluctant to press refusal to deal charges for fear of failing to prove the abuse. Had the Commission followed this path, it would indeed have had to prove the demanding *Bronner* conditions.²⁸

In *Bronner*, the sole EU competition case involving a refusal to give access to a distribution facility, a small newspaper editor wanted to be included within the nationwide home-delivery network of a large Austrian newspaper. The ECJ dismissed the allegations of abuse. It found that for an abuse to be established, the service at stake had to be “*indispensable to carry on business*”. In turn, according to the Court, there is only indispensability if it is impossible to replicate the distribution system at stake and if there are no alternative distribution methods²⁹.

In the two *Microsoft* cases, the Commission would arguably have been unable to prove the *Bronner* conditions. First, the existence of number of competing OS to Windows showed that replication was not impossible (even on a limited basis, *see* for instance, Inux or MacOS). Second, besides distribution through OS, softwares can be, and are, distributed to end users through a variety of distribution channels (for instance, Google distributes software through its search engine, etc.). As the ECJ made clear in *Bronner*, the existence of alternative distribution channels disqualifies a finding of an abuse “*even though they may be less advantageous*”³⁰. Third, the Commission had found that Microsoft benefited merely from a “*competitive advantage*” through pre-installation and could not demonstrate that there was an “*elimination of competition*” in a related market, pursuant to the last condition of the essential facilities case-law.

In light of this, it comes as no surprise that the Commission followed a “*tying*” theory of harm in the *Microsoft* cases. The test for tying abuses is indeed laxer and easier to satisfy.³¹ Moreover, on procedural grounds, the selection of a “*tying*” scenario did not preclude the negotiation of

²⁷ From a factual standpoint, it is doubtful that rival software producers ever requested access to Microsoft’s OS. From a historical standpoint, this was also the path that had been envisioned in the US (See for example: *United States v Microsoft*, District Court for the District Of Columbia, 11 May 1999, Civil Action No. 98-1232 (TPJ) ; D. EVANS, A. NICHOLS and R. SCHMALENSEE, “*United States v. Microsoft: did consumers win?*”, *Journal of Competition Law & Economics*, 1(3), 2005, p. 497).

²⁸ ECJ, 26 November 1998, C-7/97, Oscar Bronner v Mediaprint, *ECR*, 1998, p. I-7791, para. 41.

²⁹ By virtue of technical, legal or economic obstacles. *Ibid.*, para. 43 and 44.

³⁰ *Ibid.* para. 43.

³¹ A. JONES and S. SUFRIN, *EC Competition law. Text, Cases and Materials*, Oxford, Oxford University Press, 2008, 3rd ed., pp. 516 and 520.

heavy “*essential facility*” remedies with the parties.³² This, in turn, is because the Commission enjoys a large leeway in devising remedies under Regulation 1/2003.³³ In particular, firms which offer commitments under the Article 9 commitments procedure irreversibly accept that the concessions they make may go beyond what the Commission could have itself imposed on them³⁴, even if the concerned firm was, like Microsoft, threatened to be heavily fined for recidivism.

Finally, the Commission – and the EU courts – have already applied this circumvention reasoning in other areas of abuse of dominance law. For instance, in a number of cases, the Commission has resorted to Article 102 c) to condemn discount schemes that did not fall neatly within the case-law on abusive rebates³⁵.

IV. Conclusions

In conclusion, the Commission’s illusionist tricks are a source of concern. First, the *Microsoft* decisions entail a possible reduction of the threshold for intervention in both “*tying*” cases – through the obliteration of the coercion requirement – and “*essential facility*” cases – through the use of circumvention tactics.³⁶ The cumulative effect of these two trends leads to a dangerous collapse of the standard of proof for refusal to supply cases which can now be proven by mixing a weakened tying standard with elements of behavioral economics.

Second, the application of radically different remedies to similar cases – which range from “*untying*” to “*must carry*” solutions – is somewhat problematic. Dominant firms willing to comply *ex ante* with the competition rules in high tech industries face now two polar options, with opposite practical consequences. In this context, it should be noted that must carry remedies

³² It is noteworthy that subject to compliance with the “*proportionality*” principle (which entails, amongst other things the prevalence of behavioural over structural remedies), EU competition law does not ascribe specific remedies to particular types of abuses. Absent a formal nexus between the remedy and the suspected abuse, the Commission could thus apply “*must carry*” remedies which went possibly beyond conventional remedies in tying cases.

³³ Article 7 of Council regulation (EC) No 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty states that the Commission may impose “*any behavioural or structural remedies which are proportionate to the infringement committed and necessary to bring the infringement effectively to an end*”.

³⁴ ECJ, 29 June 2010, C-441/07 P, *Commission v Alrosa*, para. 48 [not yet reported in *ECR*].

³⁵ D. GÉRADIN and N. PETIT, “Price Discrimination Under EC Competition Law: Another Antitrust Doctrine in Search of Limiting Principles?”, *Journal of Competition Law and Economics*, Vol. 2, Issue 3, 2006, pp. 530-531.

³⁶ The Guidance Communication confirms this. Coercion is no longer a condition for unlawful tying (*see* para. 50).

involve high transaction costs, especially when the parties have to negotiate a proper remuneration for access to the indispensable facility³⁷. Additionally, it may create pro-collusive dynamics on oligopolistic markets as competitors are bound to cooperate, exchange information and may control the activity of their rivals through the management of the indispensable asset³⁸.

To say something trite, but true, the fluctuating borders of tying law are not entirely in line with the needs of legal certainty of firms in fast moving industries, where product/software integration is pervasive.

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³⁷ A. CANDEUB, “*Trinko* and Re-Grounding the Refusal to Deal Doctrine”, *University of Pittsburgh Law Review*, Vol. 66, p. 821, who argues that an order to supply will be successful only if the transaction and governance costs of the remedy are relatively low.

³⁸ N. PETIT, *Oligopoles, collusion tacite et droit communautaire de la concurrence*, Bruylant-LGDJ, Bruxelles-Paris, 2007, 685 p.