Strong Spine, Weak Underbelly: The CFI *Microsoft* Decision

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Introduction

The CFI's decision in *Microsoft* came as something of a surprise. In the run-up to its issuance, commentators had been predicting some sort of "split-the-difference" approach, seeing the Court as most likely upholding the Commission's decision on Microsoft's refusal to supply interoperability information to Sun but reversing its decision on Microsoft's refusal to dis-integrate Windows and the Windows Media Player. I thought the opposite. Immediately after the Commission's decision in 2004 Microsoft had petitioned the CFI for interim relief to suspend the Commission's remedial orders. Although the CFI denied the petition, Judge Vesterdorf, President of the CFI, had not dismissed Microsoft's attack on the interoperability issue out of hand. He recognized that there was a serious dispute on a number of points. Was the protocol information "indispensable" within the meaning of prior case law? Was the assertion of intellectual property rights to these protocols sufficient, in itself, to constitute an "objective justification" for a refusal to provide the information? Microsoft's contention that the Commission's decision was wrong on these points, Judge Vesterdorf wrote, "could not be regarded as prima facie unfounded." I took that to mean that Microsoft had some plausible defenses.

The surprise, to me, was how completely and thoroughly the CFI demolished those defenses. This was an opinion in the style of Woody Hayes (the legendary Ohio State football coach)—three yards and a cloud of dust, relentlessly moving down the field, but with few exciting long passes. On virtually all points of contention, the CFI, after stating the arguments on both sides, agreed with the Commission's analysis of the applicable case law and how the Commission marshaled the facts to support its conclusions. Indeed, the Court's language on more than one occasion shows, perhaps, some impatience with Microsoft's arguments: Microsoft's complaint about whether the Commission needs to prove more than a "risk" of anticompetitive effect in the targeted market "is purely one of terminology and is wholly irrelevant" (para. 561). "Microsoft's assertions [about its competitors in the work group server operating system market] . . . are scarcely credible" (para. 592). Microsoft's arguments about the exact language of Sun's request "are purely formal and must be rejected" (para. 773). Microsoft's arguments that the bundling analysis is

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inconsistent with Article 82(d) of the EC Treaty "are purely semantic and cannot be accepted" (para. 850). Microsoft's arguments that tying the Media Player to Windows did not result in foreclosure of competition and that the Commission applied a new and speculative theory are "unfounded and . . . based on a selective and inaccurate reading of the contested decision" (para. 1033). Not the first time Microsoft has aroused these reactions, as I will mention further below.

There are many interesting points in the CFI's opinion, but I want to focus my comments on three important ways in which the opinion stiffens the strong spine of European competition law when it comes to judging the conduct of dominant firms: (1) having an intellectual property right does not give its holder an immunity from competition law, no matter how much money the holder claims to have invested in creating that right (or in the product that the right effectively protects); (2) thoroughly analyzing the competitive effects of a tying arrangement, rather than just presuming those effects, strengthens any decision to condemn a tie; and (3) leverage theory is alive and well in the European Union.

But the CFI's decision, along with the Commission's decision, also reveals the soft underbelly of competition law, and not just in the EU. That soft underbelly is remedy, for it is unclear that the remedies the Commission ordered will be any more effective in bringing competition to bear on Microsoft than the remedies ordered in the government monopolization cases in the United States.

Strong Spine

Intellectual Property

Intellectual property rights became an increasingly important defense for Microsoft as the case moved from the Commission to the Court. In two important earlier cases, *Magill* and *IMS Health*, the European courts had decided that in certain "exceptional circumstances" it could be a violation of Article 82 for the holder of an intellectual property right, dominant in its market, not to license that right.[1] Four necessary conditions had emerged from these cases to show a violation: (1) indispensability of the requested information or product to the requester's business; (2) "preventing the emergence of a new product for which there is a potential consumer demand"; (3) exclusion of "any competition on a secondary market"; and (4) lack of objective justification.[2]

Microsoft had made a maximalist argument to the CFI—its refusal to supply the information was objectively justified by its intellectual property rights

[1] See Case C-418/01, IMS Health GmbH & Co. OHG v. NDC Health GmbH & Co. KG, 2004 E.C.R. I-5039; Commission Decision 89/205, Relating to a Proceeding Under Article 86 of the EEC Treaty (IV/31.851 — Magill TV Guide/ITP, BBC and RTE), 1989 O.J. (L 78) 43 (EC).
[2] See IMS Health, para. 30.

because it was entitled to a reward from its investment and because any other result would prejudice its incentives to innovate. In other words, it had an absolute right to refuse to provide information to Sun because the information was protected by intellectual property rights. The Court rejected this argument squarely, pointing out that Microsoft's argument was clearly inconsistent with the previous case law which had found that a refusal to license an intellectual property right could violate Article 82 (see para. 690). The Court also refused to distinguish the prior law based on some assessment of the strength of the intellectual property right, that is, whether the right protected works that are strongly innovative or original or only protected works of lesser originality (an argument that some had made for explaining the result in the earlier cases, where the intellectual property protection was for works of slight originality).[3]

The CFI's rejection of Microsoft's claim of absolute right was gentler than the rejection in the U.S. of a similar sweeping argument that Microsoft had made to the United States Court of Appeals for the D.C. Circuit in its appeal of the governments' Section 2 prosecution. In that case Microsoft had claimed an absolute right to place whatever conditions it wanted on its customers' use of Windows in the exercise of its copyright rights. The Court of Appeals wrote that Microsoft's argument "borders upon the frivolous." It is "no more correct than the proposition that use of one's personal property, such as a baseball bat, cannot give rise to tort liability."[4]

But Microsoft not only did poorly before the CFI with its broad claim of privilege. The CFI also construed the requirements of the prior cases in a flexible way, deciding, for example, that all competition does not have to be eliminated in the "secondary market" and that hindering the technical development that can lead to new products is harm enough. The CFI could easily have taken a narrow view of the precedents, restricting the exceptional circumstances to the exact facts those cases had presented. That it did not, I think, owes much to the strong factual case the Commission presented, which made clear the impact Microsoft's refusal had on competition in the work group server market, which was inexorably moving toward a "homogeneous" Microsoft solution. In so doing, the CFI strongly affirmed the European position that competition law can appropriately be invoked to restrict the broad claims of intellectual property rights holders.

In this general approach I think the European courts are on the right track. Contrary to the views of many in the United States, and particularly those

[3] The Court pointed out that innovation or originality is "inherent" in any intellectual property right, else there would have been no patent or copyright (see para. 695).
[4] United States v. Microsoft Corp., 253 F.3d 34, 62-63 (D.C. Cir. 2001).

currently heading the Justice Department's Antitrust Division who oppose any restriction on the absolute right of monopolists to use their intellectual property rights however they see fit, I think that there are costs to innovation from allowing monopolists to manage the path of innovation. As economists such as Kenneth Arrow have pointed out, monopolists do not have perfect vision of the future and their incentives are not necessarily aligned with consumers.[5] Monopolists need to protect their current markets from convulsive change, which is just the kind that unmanaged innovation can bring. Joseph Schumpeter, who saw monopoly as the engine of innovation, may have been right when he wrote that monopoly profits are "the baits that lure capital on untried trails."[6] But when monopolists have the power to block those trails competition law needs to intervene.

The question, then, is how much intervention is necessary. Unfortunately, the CFI stopped short of clearly confronting the tension between intellectual property and competition law when it comes to the best way to incentivize innovation. In this regard it would have been better had the CFI taken the approach to "objective justification" that the Commission did when it explicitly balanced the positive and negative impact on incentives to innovate that might come from compulsory interoperability disclosure. Rather than reviewing the Commission's balance, though, the CFI chose to say that the Commission did not rely on such a balance at all but had found lack of "objective justification" in other factors (see para. 710). This approach met Microsoft's argument that the Commission had applied a "new rule" (an argument that could have affected the size of the fine the Commission could impose), but it did not do much for explaining or developing the law. This lack of explanatory power is unfortunate, for it makes European law appear to be a formal exercise of applying precedent without articulating the economic and factual arguments that make those precedents supportable.

Tying

The CFI's tying analysis at first looks much like a tying analysis in a U.S. court. Are there two products? Is the seller "dominant in the market" for the tying product? Is the customer forced to take the bundle? Does the practice "foreclose competition"?

Each of these issues is fertile ground for argument (are right shoes and left shoes separate products? can you tie them together?), but the key doctrinal

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[5] For a succinct statement of Arrow's views, see Declaration of Kenneth J. Arrow at 8-9, United States v. Microsoft Corp., 87 F. Supp. 2d 30 (D.D.C. 2000) (Civil Action Nos. 98-1232 (TPJ) & -1233
(TPJ)), http://www.usdoj.gov/atr/cases/exhibits/2517.pdf.

[6] Joseph Schumpeter, Capitalism, Socialism, and Democracy 89 (1947).

battleground today in the U.S. is whether to judge tie-ins under a rule of reason or a per se rule. In its 2001 *Microsoft* decision the D.C. Circuit had held that a rule of reason should be applied to the plaintiffs' claim that the tying of the browser to the operating system violated Section 1. This provoked much attention from those on both sides of the debate. Curiously, and perhaps with less notice, the D.C. Circuit also found that Microsoft's refusal to allow consumers or original equipment manufacturers (OEMs) to *untie* the browser was unreasonably anticompetitive and, hence, a violation of Section 2. In this part of its opinion, the Court applied a rule of reason balancing methodology.

The CFI's approach is an interesting mix of what the D.C. Circuit did. Operating in Article 82 territory, and without the formal encumbrance of the per se/rule of reason distinction, the CFI's opinion lines up as a combination of the D.C. Circuit's Section 1 and Section 2 analyses. The CFI finds two products under a consumer demand approach (see para. 917), based on the facts that existed when the bundling occurred, but notes that the IT industry is one in which subsequent evolution in product development could later change such a conclusion (see para. 913). This type of evolution was one of the reasons that the D.C. Circuit chose a rule of reason approach in its Section 1 analysis. The CFI also applies an additional factor to its tying analysis, "absence of objective justification." This factor stands somewhat outside those normally articulated as part of tying analysis, and the Court does not make a formal statement that this is a necessary part of the analysis. But under this heading the CFI examines Microsoft's efficiency justifications for the way it integrated the Windows Media Player into Windows (as did the Commission). The CFI also goes to some pains to point out that the Commission did a full analysis of the actual competitive effects of bundling, rather than merely assuming, "as it normally does in cases of abusive tying," that the tying of a "dominant product" to a second product "has by its nature a foreclosure effect" (see para. 868). Whether this type of analysis is always required is not stated, but the CFI closely examines the reasons presented by the Commission for finding anticompetitive effect. All of this sounds like a rule of reason analysis to me, one that makes a more persuasive case for condemning any particular tying arrangement than mere reliance on a presumption.

Two points stand out in the CFI's analysis, both related to the analytical construct of a balancing test. First, the CFI looks closely at the exact claim of abusive behavior that the Commission is presenting. It is not the integration of the media player into the operating system that is the problem. The problem is the refusal to offer a dis-integrated version of Windows (see paras. 1149-50). In this the CFI and the Commission saw exactly what Judge Jackson saw at trial and the D.C. Circuit saw in its Section 2 analysis of the browser and operating system

tie—users could not *remove* the browser. Critics of the CFI and the Commission would do well to focus more on what was actually at issue in the case, rather than complaining that monopolists will not be able to tell if they can integrate new features into existing products. They can. Indeed, so long as the costs of offering a dis-integrated version are not excessive, is it not likely better for innovation and consumer choice if consumers have a real chance freely to choose who will supply that "new feature"?

The second point is that an inquiry into competitive effects undercuts the clarity of a rule that presumes such effects, making counseling harder. But this should make critics of the per se rule happy, unless, of course, the push for a rule of reason analysis is simply classic bait-and-switch, and what critics really want is a rule of per se legality. Per se legality will certainly make counseling easier.

Leveraging

Throughout its opinion the CFI emphasizes the idea of "leverage," concluding that the two abuses are part of a "leveraging infringement," consisting of Microsoft's use of its dominant position in operating systems "to extend that dominant position to two adjacent markets" (para. 1344). In fact, in its review of the refusal to supply issue, the CFI pointed out that even if the Commission were wrong in finding that Microsoft had reached a dominant position in the work group server operating system market, "that could not therefore of itself suffice to support a finding that the Commission was wrong to conclude that there had been an abuse of a dominant position by Microsoft" (para. 599). In other words, a finding of monopoly in a second market is not required for a leveraging violation.

Pure leveraging without proof of effect in a second market is much disfavored in U.S. antitrust law. The Supreme Court in *Trinko* gave the doctrine a footnote brush-off, writing that there must be proof of at least attempted monopolization in a second market.[7] Judge Jackson in the U.S. *Microsoft* litigation dismissed the states' leveraging claim on summary judgment, a decision that was never appealed. The notion of "leveraging" into a second market thus played no part in the U.S. case.

Leveraging could be a broad theory for European competition law enforcement if the CFI were serious in saying that a leveraging infringement can be shown simply by a "strengthening" of the dominant firm's position in a second market (see para. 1347). But those were not the facts in the *Microsoft* case itself, where the Commission was careful to show the extent to which Microsoft's conduct led to dominance (or at least dominance sufficient to count as attempted monopolization in the U.S.) in the work group server and media player markets

[7] *See* Verizon Commc'ns Inc. v. Law Offices of Curtis V. Trinko, 540 U.S. 398, 415 n.4 (2004).

which the Commission analyzed. Actually, even in *Trinko* the leveraging in which Verizon allegedly engaged would have been done to maintain its monopoly position in local phone service.

In some ways, leveraging as a theory has received a bum rap. It has not really been applied in cases where all that the plaintiff has shown has been some advantage in a second market, because generally defendants who are sued for this behavior either are protecting monopoly in the second market or are pretty close to attaining it. What the CFI's opinion does is to maintain the respectability of the idea of "leverage" as a way to describe and analyze a monopolist's strategic behavior. This would be useful if for no other reason than it tracks how business people describe their own strategies, as in this Microsoft email quoted by the CFI: "[Microsoft] has a huge advantage in the enterprise computing market by leveraging the dominance of the Windows desktop." This, in itself, tells us something about how to evaluate a monopolist's conduct.

Soft Underbelly

In the immediate aftermath of the CFI's decision, Commissioner Kroes was quoted as saying that she would like to see a "significant drop" in Microsoft's nearly 95 percent share of the desktop operating system market.[8] She won't. The CFI made a more accurate prediction: "Since Microsoft is very likely to maintain its dominant position on the client PC operating systems market, at least over the coming years, it cannot be precluded that it will have other opportunities to use leveraging vis-à-vis other adjacent markets" (para. 1363).

In making its prediction of continued monopoly the CFI was actually closer to the view expressed in 2001 by Charles James, then-head of the Justice Department, when he defended the DOJ's settlement. The settlement's prohibitions, James testified, "had to be devised keeping in mind that Microsoft will continue for the foreseeable future to have a monopoly in the operating systems market."[9] How right James was. Five years of enforcing the U.S. decree has not dented Microsoft's monopoly hold on the desktop operating system market.

Remedy is the soft underbelly of competition law enforcement, revealed by the three remedial orders the Commission imposed on Microsoft in its initial decision: (1) offer an additional version of Windows without the Media Player; (2) supply the requisite interoperability protocols; and (3) pay a €497 million fine

[8] *See* Charles Forelle, *Microsoft Loss in Europe Raises American Fears*, Wall St. J., Sept. 18, 2007, at A10.

[9] Statement of Charles A. James, Ass't Att'y Gen'l, Antitrust Div., *The Microsoft Settlement: A Look to the Future*, Sen. Jud. Comm., Dec. 12, 2001, at 10, *available at* http://www.usdoj.gov/atr/public/testimony/9681.pdf.

for the two violations. The first has amounted to little, in part because the Commission did not force Microsoft to charge less for the version without the media player. Not surprisingly, the unbundled version is unpopular. The second has yet to be complied with. In 2005 the independent monitoring trustee called Microsoft's documentation "not fit for use by developers" and in 2006 the Commission imposed a €280 million fine for noncompliance, plus an additional €3 million a day for continued noncompliance.[10] The fine continues to mount and the Commission is now arguing with Microsoft over the license fees that Microsoft has proposed for the protocols.

The CFI's decision reviewed only the third remedy, the original fine decision. The Commission had arrived at the fine by doubling its starting-point fine amount, in an effort to achieve adequate deterrence. The CFI upheld this increase, recognizing that extra deterrence was needed because, as pointed out above, Microsoft will continue to have "other opportunities" to engage in the same behavior. Predicting deterrence is always a tricky business, of course, but it does not appear that the threat (and subsequent imposition) of substantial additional financial penalties deterred Microsoft from violating the Commission's 2004 interoperability disclosure order. What can we predict, then, about specifically deterring Microsoft's future leveraging violations of Article 82, or, indeed, about achieving general deterrence in these types of cases?

On April 20, 2007, at the ABA Antitrust Section's Spring Meeting in Washington, Commission Kroes was asked what the Commission has learned about remedies from its experience in *Microsoft*. After first saying that the Commission had "never before" encountered a company that had refused to comply with its order, she said that the Commission would need to consider when "structural remedies would be more appropriate or even necessary." For example, she said, "there could be a situation in which a dominant company has repeatedly abused its dominant position. Or where it has consistently failed to comply with a behavioural remedy despite repeated enforcement action."[11]

It sounds to me as though Commissioner Kroes has now learned what Judge Jackson learned over the course of the U.S. monopolization trial. Microsoft's unwillingness to comply with court-ordered remedies, plus its pattern of exclusionary conduct, indicated that conduct remedies alone would not likely be effective. An effective remedy would need to change Microsoft's economic incentives. This was the key insight of the restructuring remedy originally proposed by the Justice Department and the states, and adopted by Judge Jackson.

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[10] *See* Comm'n of the European Comtys., Comm'n Decision of 12 July 2006, Case COMP/C-3/37.792 Microsoft ¶ 52, Arts. 1, 3.

[11] *See* Transcript of Remarks, EC Press Office, quoted in email from David Lawsky@reuters.com, Apr.25, 2007 (author's files).

That remedy was never imposed—new leaders took over at the Department of Justice and the parties entered into a conduct settlement. Unfortunately, Europe has repeated the U.S. history, with similar results.

Conclusion

The CFI's decision is a careful review of the Commission's findings, thorough in considering the factual arguments presented by the parties but less clear in explaining the reasons behind the legal doctrines it applies. Overall, it affirms the balancing approach in which the Commission engaged, albeit without embracing this analytical structure as clearly as did the D.C. Circuit in its review of the *Microsoft* monopolization case. Unfortunately, though, the Commission remains mired in its effort to force protocol disclosure, an unhappy task that, on the U.S. side, led the District Court in *Microsoft* to extend for at least another two years the provisions of its decree dealing with protocol disclosure. As for the fines, they are now in escrow awaiting the conclusion of the case. If Microsoft chooses to appeal, that could be years off.

Perhaps next time Europe will think about a structural remedy. That approach might have been faster and more effective.