

Dominant Position (Computer Software) : the Microsoft Case

Subject: Dominant Position

Industry: Computer software

Parties: Microsoft

Source: Commission Statement IP/00/141, dated 10 February 2000

(Note. This is a helpful and interesting statement about the ways in which the Commission has been involved in the problems of reconciling Microsoft's business policy with the rules on competition. The paragraph outlining the difference between the European and American charges could perhaps have been clearer: the Commission says that the US proceedings "seem to revolve" around the question of market dominance for PC operating systems. Yet several of the past and current cases referred to by the Commission towards the end of its statement are concerned with, or at least overlap, a similar question. The outcome of the various cases in the USA and Europe is of incalculable importance to consumers, a point which is not given prominence in the statement.)

On the basis of information received from end-users, small and medium-sized enterprises active in the IT (information technology) sector and competitors of Microsoft, the Competition Directorate General of the Commission has formally requested Microsoft to provide information about the new technical features of Windows 2000 in the context of EC competition law. This information should allow the Commission to verify allegations that Microsoft has designed Windows 2000 in a way which will permit leveraging of its dominance in PC operating systems onto the market for server operating systems and ultimately that for thriving e-commerce.

According to allegations received by the Commission, Microsoft, by virtue of Windows 2000, has bundled its PC operating system with its own server software and other Microsoft software products (that is, "middleware" which provides functionality enhancing the performance of client/server operating systems such as back office or security tasks) in a way which permits only Microsoft's products to be fully interoperable. Microsoft's competitors, which do not have access to the interfaces would therefore, according to the allegations, be put at a significant competitive disadvantage which would ultimately allow Microsoft to extend its dominance in PC operating systems into the closely related markets for server operating system software and "middleware". According to the allegations, in order to ensure full exploitation of functionalities embedded in Windows 2000 for PCs, customers would *de facto* be obliged to purchase Windows 2000 for servers.

As a result of the information it has so far obtained, the Commission has sent a formal request for information to Microsoft in accordance with Article 11 of Regulation 17/62. The Commission will examine whether the above allegations concerning an infringement of EC competition law caused by the design of Windows 2000 are well founded.

Background: How does this investigation relate to the US trial ?

The Commission points out that it is important to differentiate between the trial in the USA and the Commission's first step in a preliminary examination of the allegations with which it has been confronted. The US and EC proceedings are different. The allegations which the Commission has now decided to examine more closely centre on Microsoft leveraging its dominance from one market (PC operating systems) onto other markets, whereas in the US the main thrust of the proceedings seems to revolve around Microsoft protecting its dominance on the market for PC operating systems.

Timeframe and next steps: What are the next steps in the Commission's investigation ?

The Commission has given Microsoft four weeks to respond to its questions. Their answers will then have to be carefully analysed. It is on the basis of this analysis that the Commission will decide its next steps. At this stage it is impossible to forecast the outcome of the examination. Generally speaking, the Commission's options are laid down in Regulation 17/62. In this context, if the Commission considers that EC competition law is being infringed, it can initiate a formal examination procedure by sending a statement including the objections raised against the company concerned.

At this stage, this is only one option among others depending on the outcome of the examination. The Commission needs to examine Microsoft's answers and supplementary information from other sources first to be able to assess the merits of the allegations. This is not the first time nor the first examination in which the Commission has been confronted with allegations concerning the competitive impact of Windows 2000.

Legal framework: What is the legal framework in which DG COMP's investigation is situated ?

The examination is taking place in the framework of Regulation 17/62 implementing Articles 81 and 82 of the EC Treaty. The formal request has been sent on the basis of Article 11 of Regulation 17/62. The Commission has thus started a so-called *ex officio* procedure. It should be emphasised that at this stage the Commission has initiated an examination but has not opened a formal procedure against Microsoft.

Sources of information and allegations: Why is the Commission concerned about Windows 2000 ?

The Commission has been approached by end-users, small and medium-sized enterprises active in the IT sector and competitors of Microsoft who had been given access to beta versions of Windows 2000. The parties who have contacted the Commission do not want to be named. Nevertheless, their submissions were sufficiently substantiated to justify the Commission's formal request to Microsoft for information.

Charge in legal terms: What exactly is the charge against Microsoft ?

There is no accusation yet. This is important to remember. The Commission is at present in a preliminary examination stage. The allegations which have been made would indicate the applicability of Article 82 of the EC Treaty. Article 82 prohibits abusive and exclusionary behaviour by undertakings in a dominant position. According to the allegations which have been received Microsoft, through Windows 2000, has bundled its PC operating system with its own server software and other Microsoft software products (that is, "middleware") in a way which permits only Microsoft's products to be fully interoperable. Microsoft's competitors, which do not have access to the interfaces would therefore, according to the allegations, be put at a significant competitive disadvantage which would ultimately allow Microsoft to extend its dominance in PC operating systems into the closely related markets for server operating system software and "middleware". According to the allegations, to ensure full exploitation of functionalities embedded in Windows 2000 for PCs, customers would *de facto* be obliged to purchase Windows 2000 for servers. Microsoft would thereby shift outwards to the server market the technical barriers to entry which so far have afforded it its arguably strong position in the market for PC operating systems.

E-commerce: What about the danger for e-commerce ?

We will, no doubt, need to obtain further clarification on this point, both from Microsoft and its competitors. What appears so far is that whoever gains dominance in the server software market is likely to control e-commerce too. According to what is claimed by Microsoft's competitors and customers, Microsoft's Windows 2000 will leverage Microsoft's dominance in PC operating systems to server operating systems. This could tip the e-commerce market to Microsoft's favour.

Past Commission cases involving Microsoft

Microsoft Licensing Agreements with PC Manufacturers

In 1993, the US Justice Department took over a deadlocked investigation of Microsoft. At about the same time Novell filed a complaint with the Commission concerning Microsoft. By mid 1994, largely due to constructive exchanges of views on the issues, the two investigations had reached a common set of concerns about Microsoft's licensing of its MS-DOS and Windows products to PC manufacturers.

Negotiations between Microsoft and a joint US Justice Department and Commission team led to an agreed settlement under which Microsoft undertook to change its licensing agreements with PC manufacturers. This took the form of an Undertaking to the Commission and a Consent Decree in the US. The Undertaking was received by the Commission in July 1994 and ratified by the US court in 1995.

Santa Cruz v. Microsoft

In 1997 Microsoft's competitor Santa Cruz Operation (SCO), a Californian software company specialising in systems for network computing, complained to both the Commission and the US Justice Department about its contractual relationship with Microsoft invoking restraints of competition due to the agreements and referred to Microsoft dominant position. The Commission discussed the case with the US Justice Department, which felt that it would take more time to address these concerns under US Law. They agreed to the Commission moving first. A Statement of Objections was sent and Microsoft waived its rights under the contract clauses to which the Commission objected before a scheduled oral hearing. These changes addressed the competition concerns in both the EEA and the US. The case was closed.

Microsoft Internet Explorer

In early 1997, the Commission launched an ex-officio investigation of certain Microsoft contracts with European Internet Services Providers (ISP). During this inquiry, Microsoft was informally requested to re-examine the agreements in the light of European competition rules to ensure that they did not contain restrictions which might have the effect of illegally foreclosing the market for Internet browser software from Microsoft's competitors and of illegally promoting the use of Microsoft's proprietary technology on the Internet. Microsoft subsequently amended its agreements and notified the revised agreements to the Commission. Considering that Microsoft removed illegal clauses and that the notified agreements no longer infringed EC competition rules, the Commission cleared the agreements by way of a comfort letter pursuant to Article 81(1). The comfort letter only covers the agreements between Microsoft and ISPs. In this particular case, the Commission did not give any ruling on the global behaviour of Microsoft concerning a possible abuse of dominant position.

Micro Leader v Microsoft

The charge brought against Microsoft was that it applied different prices to equivalent transactions with trading partners. Micro Leader is a wholesaler of software in France. It imported Microsoft software (operating systems, application programs) from Canada to France to sell it there. The software was allegedly identical to that supplied by Microsoft's French distribution channels but cheaper. Microsoft considered that the imports led to unfair competition in France and brought to bear its intellectual property rights concerning the software. Micro Leader filed a complaint with the Commission relying both on the concept of an abuse of a dominant position and on the concept of agreements between companies with a view to restricting competition (Article 81 of the Treaty). The Commission decided to reject the complaint on the grounds that the complainant had not provided sufficient evidence for its charges.

Micro Leader appealed at the Court of First Instance (CFI). The CFI upheld the Commission's arguments as far as the charge of restrictive agreements contrary to Article 81 was concerned. Nevertheless, it annulled the decision with reference to Article 82: according to the judgment, Micro Leader had provided sufficient

indications that Microsoft did charge higher prices in France than in Quebec. The CFI furthermore stated that in exceptional circumstances intellectual property rights would not necessarily constitute a valid defence if a conduct were found to constitute an abuse of a dominant position. We have already started re-examining the case in accordance with the CFI's findings. Microsoft will have to provide information on its pricing policy and provide reasons for any possible differences in prices for prima facie identical products. ■

The Emerson / Ericsson Case

The European Commission has cleared the acquisition of Ericsson Energy Systems (EES) of Sweden by the American company Emerson Electric. Both companies are active in the manufacturing of energy systems for the telecommunications sector. The Commission found that the combined market shares of Emerson and EES were relatively modest and the operation would not impede competition in the EEA.

Emerson Electric Co. ('Emerson') which manufactures a broad range of products for process control, automation, air conditioning, and other applications has purchased Ericsson Energy Systems ('EES') from the Swedish telecommunications manufacturer Ericsson AB. EES has factories in Sweden, and also in Latin America, the Far East and elsewhere, from which products are sold to telecommunications manufacturers and operators worldwide.

Energy systems include embedded power supplies such as AC/DC converters, which are sold to telecoms manufacturers for integration into the telecoms equipment itself; power systems which are stand-alone systems, functionally similar to embedded systems, which are sold to telecoms operators; and systems which provide the refined temperature and humidity control required in telecoms or informatics operating installations. The Commission has found that the geographic markets for all three types of product are at least EEA wide, in view of the fact that manufacturers tend to locate their factories in a limited number of locations from which they ship their products throughout the EEA or the world, in view of significant intra-EEA trade flows, and in view of relatively low transport costs. The combined EEA shares of Emerson and EES for all three types of product are relatively modest.

The EEA markets for the relevant products include strong competitors such as Lucent, Alcatel and Marconi. Customers include companies such as Vodaphone, Telefonica and Cable and Wireless, who should be able to exercise a significant degree of buying power. In view of the above the Commission has decided not to oppose the operation. (Source: Commission Statement IP/00/267, dated 16 March 2000.)