

CFI's *Microsoft* ruling may threaten R&D in Europe

What impact will September's *Microsoft* ruling have on IP owners in Europe? [Helen Davison](#) reports from a seminar hosted by the Stockholm Network and Managing IP

An eight-year struggle between two giants – the European Commission and Microsoft – was resolved on September 17 2007. The ruling of the Court of First Instance of the European Court of Justice (CFI) was expected to provide much needed answers regarding the relationship between competition rules and IP rights, the scope and essence of trade secrets, the boundaries of anti-trust activities and the issue of abuse of dominant power.

As it turned out the ruling could not have been clearer. The CFI found that Microsoft abused its dominant position both for bundling the operating system Windows with Windows Media Player and for refusing to supply interoperability information in the work group server operating system market. The fine of €497 million was confirmed and Microsoft has been ordered to license its protocols to allow competitors to operate and to untie its Media Player from its windows operating system.

The manner in which the CFI chose to interpret these issues has fallen very clearly on the side of competition rules and at the expense of the protection of IP rights. This may have repercussions for the legal, economic and technological horizons of knowledge-intensive activities in the EU.

Roundtable

On October 3 2007, the Stockholm Network teamed up with *Managing IP* for a special roundtable event to discuss the impact of this ruling. The session was attended by a range of academics and policy-makers, as well as a spread of industry figures drawn from a diverse range of industries from pharmaceutical to creative, testifying to the impact this ruling will have on any industry that relies on IP protection.

Speakers included Aurelien Condomines, the partner in charge of antitrust at the Aramis law firm in Paris; Federico Etro, associate professor of economics at the University of Milan, Bicocca, and president of Intertic, the first academic think tank on innovation and competition and Martin Campbell-Kelly, professor of computer science at Warwick University. They provided views on the legal, economic and technological implications of the ruling. The roundtable was moderated by Meir Pugatch of the Stockholm Network and James Nurton of *Managing IP*, and introduced by Helen Disney of the Stockholm Network.

The ruling

The complaint concerned two key technical issues, the interoperability between Windows Workgroup Servers and com-

One-minute read

In September, the Court of First Instance upheld a European Commission ruling that Microsoft had abused its dominant position, and affirmed a fine of €497 million. The ruling analyzed in detail the relationship between competition and IP rights, and helped to define under what “exceptional circumstances” companies can be forced to license their intellectual property. At a roundtable seminar in Brussels last month, the legal, economic and technological implications of the ruling were discussed. From all three perspectives, the ruling raises concerns for IP owners, particularly those in a dominant position in their market. It will lead to increased uncertainty about the extent to which competition law can limit the use of IP rights, as the scope of exceptional circumstances appears to have been further broadened. This may point to a bleak future for innovation in Europe.

peting servers and the tying of Windows Media Player with the Windows desktop operating system.

These two issues are not as distinct as they first appear. They are united by the desire of the European Commission (DG Competition) to see other suppliers create substitutes for Microsoft's products in the hope of boosting competition in the software market, such as in the fields of operating systems and media platforms. However, there was some disagreement between the speakers over which parts of the ruling were more important in terms of their longer-term implications.

Legal uncertainty

Although the purpose of the case was to establish clear principles for the future conduct of a company in a dominant position, legal uncertainty has resulted from the broadening of the “exceptional circumstances” test that was established in the *Magill* case.

On the issue of tying, Condomines called the ruling “unsurprising” as the legal precedence of asking companies to unbundle their products was well established under EU law.

On interoperability, though, the precedents set were far more alarming and the decision more controversial. The main question here is, based on Article 82 of the EC Treaty, under what conditions a company with a dominant market position may be forced to license its IP rights to its competitors for the sake of maintaining competition in the market. The 1995 *Magill* case established that under “exceptional circumstances” a company could be forced to license its IP rights if it was established that the refusal to license was preventing the emergence of a new product for which there is consumer demand. This principle was reconfirmed in the *IMS Health* case, (2004) which seemed to expand the definition of “exceptional circumstances” to include the licensing of IP rights for the sake of allowing competitors to introduce competing and not merely new products.

The *Microsoft* ruling, however, has stretched this test much further. In this case the court has ruled that Microsoft should



Speakers at the roundtable (left to right): Martin Campbell-Kelly, Aurelien Condomines, James Nurton, Helen Disney, Meir Pugatch, Federico Etro

licence its IP rights and disclose its trade secrets to allow its competitors to come up with similar or essentially identical products. This may have significant implications on the degree to which IP-intensive companies with a dominant market position may be exposed to lawsuits and demands to license their IP rights to their competitors.

Punishment of market leaders?

The theme of uncertainty for market leaders was taken up in the second session, which focused on whether the ruling was good or bad for the wider economy, in particular for consumer welfare.

Federico Etro argued that while there is a wide economic consensus on giving priority to the interests of consumers, the *Microsoft* case is a clear example of an antitrust case in which the interest of consumers has played a marginal role. First, the case started and developed without a single consumer or any consumer association complaint about Microsoft's conduct, but instead arose from complaints made by Microsoft's rivals in different markets. Second, economic analysis of the interests of consumers has played virtually no role in the discussion of the case emerging from the official documents.

The session then focused on to the role of market leaders in innovative markets and the importance of the protection of IP rights in stimulating investment in R&D and technological progress. It was questioned whether the potential reduction in expenditure on R&D would be tempered by the stimulating effect on investment by competing firms.

This was ruled out given that there was no empirical evidence to suggest that in the IT sector more innovation will be generated by the market leader's competitors. In fact, it was argued that, given the role of market leaders in promoting and pushing innovation, the incentives to innovate were reduced as market leaders may now be exposed to punitive actions.

An end to integration?

The third and final session focused on the technological implications of the ruling on the software industry.

The speakers speculated that the ruling might well change software development practices, because it would appear that any software product could become subject to compulsory licensing and the requirement for a coherent set of specifications, whether they exist or not. The decision will therefore push interoperability issues higher up the design agenda, which could constrain design creativity.

The issue of product integration was deemed more troubling for the industry as the history of software products is one of software integration to improve products. Frequently,

new features start out as complementary products (often called add-ons or plug-ins) to a market-leading product. It was pointed out that, today, one could not conceive of a word processor without an integrated spelling checker but in the early 1980s, spell checkers were not fully integrated into word processing programs.

The ruling leaves unanswered questions regarding how it will apply to certain dominant industry players. For example, what will be the position of open source software distributors? Will distributors be obliged to offer several

media players and more than one office suite? Does the fact that the software is free make any difference? It ought not to, if the Commission's aim is to enhance competition and consumer choice.

The discussion also focused on the implications for innovation in other sectors. With regards to the web services industry, and companies such as Google, the impact of the ruling is unclear. Google does not supply software products as such, but instead runs its proprietary software on its servers on our behalf. The difference between software products and web services is simply one of location – whether the software runs on your own PC or on the supplier's server. Google is the dominant web services company, and its search portal integrates numerous other services – maps, news, online payments, video services, and many more. It would seem that Google will eventually have to unbundle its services in a way that fosters more competition. How that will happen is unclear.

Clear principles or uncertainty?

Although the discussion covered a range of issues, overriding themes emerged concerning the ruling's impact on R&D and innovation in Europe, its impact on the consumer and how far the CFI would eventually go in its rulings on competition, intellectual property and abuse of dominant position.

The ruling was referred to as “a line in the sand” for the software industry. But, as the session went on it became clear that it is more hazy than this – the line seems to keep being redrawn as more and more competition cases are pursued in the CFI. It remains to be seen just how far the European Commission will go in pursuing its competition agenda in IP-based industries. At the moment all dominant and near to dominant companies can do is to proceed with caution, refrain from bundling and ensure that competitive space is maintained – but even these actions might not be enough if the Commission continues to pursue its present agenda.

There seems to be an alarming trend from *Magill* to *IMS Health* to the latest *Microsoft* ruling to widen the scope of “exceptional circumstances”. The implications of this for the software industry and for other sectors should not be disregarded. “The Day After Tomorrow” may be bleak for innovation in Europe.



Helen Davison

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