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CASE NOTE:

The EU *Microsoft* Antitrust Case

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An eCCP Publication

September 2007

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by

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On September 17, 2007, the European Commission's (EC) antitrust decision of 2004 on Microsoft was upheld on appeal almost in its entirety by the Court of First Instance (CFI). The case had two parts: the first on the inclusion of Windows Media Player ("WMP") in Windows, and the second on the interoperability of Windows clients with Sun servers. The consequences are significant both for Microsoft and the computing industry.

With regard to media players, the Commission forced Microsoft to sell in Europe "Windows-N," a version of Windows without WMP. Microsoft complied. Windows-N sales were less than 1% of Windows sales. It is evident that consumers and computer manufacturers do not want an operating system with less functionality. However, with its decision upheld, the Commission can now force any dominant firm (and remember that dominance can be established at much lower market shares in the EU than the U.S.) to sell products with functionality or components removed from them.

Is the EU requirement likely to make a difference? The marketplace said no. And, while the EU battled Microsoft on media players for nine (!) years at the behest of Real Networks, Adobe's Flash emerged as the dominant PC video player and Apple grabbed the lion's share in the online song download market with a proprietary format. The

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Commission's "indirect network effects theory" (that the ubiquity of distribution of WMP through Windows will result in content providers coding content only for WMP and that this will reinforce the WMP market share) has been proven completely irrelevant by the marketplace.

So, both the anticompetitive network effects theory and the imposed remedy have been proven irrelevant by the marketplace. What remains? Has there been any benefit to consumers from the Commission's action? The typical consumer receives the WMP with a new Windows computer and then downloads and tries a few other media players. It takes a few minutes to download and install them—an insignificant consumers' surplus loss. It is hard to imagine that this insignificant loss drove this antitrust case. Even though the loss is small, is it remedied by the EU's approach? Not at all. Windows-N did not sell. And this was fortunate for consumers! If Windows-N were a success, consumers who bought it would have been deprived of even the knowledge that media players existed! In contrast, the U.S. Department of Justice-Microsoft consent decree allows key Microsoft middleware (such as WMP and Internet Explorer) to be in Windows but gives the choice to both the computer manufacturer and the consumer to select the default media player, Internet browser, etc. Thus, the U.S. consent decree gives the consumers choice while the EU rule deprives them of choice.

More generally, software development has progressed with constant additions to functionality of existing software. This is true across the whole software sector. The Commission's approach was to "freeze" Windows (or any dominant firm's product) and force the dominant firm to sell the "frozen" version side-by-side with the expanded-functionality version. The marketplace rejects the frozen version, so this rule hardly

remedies anything. In the U.S., the eight States that did not sign the consent decree went one step further in their proposed remedy—they required Microsoft to sell a frozen version of Windows and set a specific price difference between the full and the frozen versions. Judge Kollar-Kotelly of the United States District Court for the District of Columbia, correctly rejected this approach as overly regulatory. The court was, essentially, asked to guess what the marketplace would pay for each new feature of Windows—a judicial nightmare.

On interoperability, the Commission imposed the requirement on Microsoft to license communications protocols between Windows clients and non-Windows servers. Interoperability defines the ability of two products to work together. In software, there can be varying degrees of interoperability. Some interoperability can be guaranteed by the interface between the components. But full interoperability between say a Sun server and a Windows client requires the understanding of exactly how internal functions in the Windows client work. Requiring disclosure of the interface between products is one thing; requiring disclosure of the internal functions of a product (since this may be the only way to reach full interoperability) is much more onerous. By requiring full disclosure at a nominal price, the EU decision, in effect, reduces the value of intellectual property for dominant firms. Additionally, in this particular case, full understanding of internal Windows functions is valuable to Sun beyond interoperability. To the extent that Windows clients and servers have similar technology, full disclosure allows Sun to see how the Windows server works. That is, the Commission's vertical remedy gives an advantage to Sun in horizontal competition.

The EU case outcome showed a significant divergence in antitrust standards between the EU and the U.S. Almost all observers agree that, if the EU case were tried in the U.S., it would not result in liability for Microsoft. The differences in antitrust standards (and the list can easily include a number of other countries such as Japan and Korea) imply that large global companies need to comply with the most strict antitrust standards, wherever they may be, and however uncertain these standards may be. And, their competitors can peddle their potential antitrust disputes to competition authorities worldwide, and see which one might be willing to do the heavy lifting of pursuing their case. Most people complain that lawyers (and their consultants) are expensive. But compared to the cost of investing in innovation or cutting prices, lawyers are cheap. And we are still in the beginning of the next cycle of antitrust litigation in the high technology sector.

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