

# Intellectual Property Law vs. Essential Facility Doctrine. Microsoft vs. Commission.

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“The Commission does not wish to regulate the software industry but we want to stop Microsoft doing so.” Per Hellstrom.<sup>1</sup>

## Introduction

It seems that Bo Vesterdorf decided to retire with a bang. A day before he pensions off, the EU’s second highest court is expected to rule whether the European Commission was right in 2004 to find that Microsoft violated antitrust laws.<sup>2</sup>

The recent *Microsoft* action has brought spectacularly before the public's attention the tension which exists between antitrust and intellectual property law. The Commission decision published on April 27, 2004, condemned Microsoft for having abused its dominant position in the market for PC client operating systems by refusing to license interoperability information. Bill Gates' company appealed directly to the exclusive rights conferred by intellectual property rights in his defense.

Generally speaking, the goals of intellectual property and competition law are often convergent. However, the two statutory frameworks contain opposing elements as well. This renders the final balance uncertain. The convergence is in “common purpose of promoting innovation and enhancing consumer welfare”<sup>3</sup>- both laws are based on principles of efficiency. The intellectual property and competition law are both equally aimed at

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<sup>1</sup> Commission’s top lawyer, See Oates, J., ‘*MS vs. EC: Final Q&A and final pleadings*,’ April 2006, May 31, 2006 available at [www.theregister.co.uk/2006/04/29/ms\\_vs\\_ec\\_friday\\_final/](http://www.theregister.co.uk/2006/04/29/ms_vs_ec_friday_final/)

<sup>2</sup> Reuters, ‘*UPDATE 3-European Court's Microsoft ruling Sept 17-sources*,’ August 24, available at [www.reuters.com/article/technology-media-telco-SP/idUSL0585241320070605](http://www.reuters.com/article/technology-media-telco-SP/idUSL0585241320070605)

<sup>3</sup> US DOJ/FTC, 1995, FTC Intellectual Property Licensing Guidelines, para. 1

maximizing social welfare. While competition law seeks to achieve this by eliminating behavior and practices that restrict competition, intellectual property law pursues this aim by creating legal monopolies. It is from the friction of these two opposing and different policies that the conflict arises. In recent years, the question of how to fashion a remedy that would properly balance these competing interests in those rare cases where refusal to license constitutes a violation of competition law is debated widely.<sup>1</sup>

This paper will analyse the current state of the law on compulsory licensing of intellectual property rights pursuant to Article 82 of the EC Treaty<sup>2</sup>, with particular reference to the *Microsoft* action, which is currently before EC courts.<sup>3</sup>

## I A. Article 82

Many of the most controversial decisions by the Commission have been taken under Article 82<sup>4</sup>. Its largest fine in a single decision- EUR 497 million- was in an Article 82 case, where Microsoft was and still is considered to have abused its dominant position in the market for operating

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<sup>1</sup> See Giovanni Ramello, G.B., ‘*Copyright and Antitrust Issues. The Economics of Copyright, Developments in Research and Analysis*’ [2003] Wendy Gordon and Richard Watt, eds., Edward Elgar Publishers Ltd. available at SSRN: <<http://ssrn.com/abstract=352760>>

<sup>2</sup> Consolidated Version of the Treaty Establishing the European Community (EC Treaty)

<sup>3</sup> When referring to the ‘Court’ the author refers to the European Court of Justice in general, not separating the ECJ and the CFI as such in order to avoid confusion. Council Decision 93/350 (1993 OJ L144/21) transferring the private actions to the Court of First instance. Where necessary the distinction is brought out.

<sup>4</sup> Article 82 reads as follows: “Any abuse by one or more undertakings of a dominant position within the common market or in a substantial part of it shall be prohibited as incompatible with the common market in so far as it may affect trade between Member States. Such abuse may, in particular, consist in:

- a) Directly or indirectly imposing unfair purchase or selling prices or unfair trading conditions
- b) Limiting production, markets or technical development to the prejudice of consumers
- c) Applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage
- d) Making the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.

systems for personal computers (PCs) between 1998 and 2004. For the purposes of this paper Article 82 plays a very important role, and thus one should understand what the Article is about.

According to the above mentioned Article a dominant position in the relevant market is not itself illegal, nor is it prohibited and incompatible with the general purposes of the rules set out for the common market. “It is consumer welfare that is at the heart of the European Commission’s competition policy”<sup>1</sup> and therefore, as long as consumers’ choice and product quality are not affected by the presence of a single player or a company which has a dominant position in the market, this is not prohibited by the European competition policy. It is the abuse of such dominant position that is proscribed by Article 82. Firms are encouraged to compete and in the end the most efficient players should be successful. Thus, those who have been more efficient and attained market strength should not be penalized just for being dominant players, but a penalty may be imposed by the Commission for behavior of a firm with the power over the market that can affect the degree of competitiveness in the internal market.<sup>2</sup> This view has been stated by the previous European Competition Commissioner Mario Monti: “Dominant companies have a special responsibility to ensure that the way they do business doesn’t prevent competition on [the] merit[s] and does not harm consumers and innovation”.<sup>3</sup>

## **B. Essential Facility Doctrine**

There are circumstances in which a refusal to supply goods or services or to grant access to a so-called ‘essential facility’ by a dominant undertaking can amount to an abuse of a dominant position. The Microsoft case has shown that refusal to supply is a controversial and difficult topic in competition law. There are several reasons why refusal to cooperate or grant access to facilities leads to difficulties. Firstly, the legal systems of most countries

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<sup>1</sup> Walker, M. and Bishop, S., *The Economics of EC Competition Law*, 2<sup>nd</sup> ed. (London: Sweet and Maxwell Publishing, 2002) Section 2.22

<sup>2</sup> Craig, P. and De Burca, G., *EU Law Text, Cases, and Materials*, 3<sup>rd</sup> ed. (Oxford: Oxford University Press, 2003) at p.p.992-993

<sup>3</sup> See Press Release IP/04/382, European Commission, *Commission concludes on Microsoft investigation, imposes conduct remedies and a fine*, March 24, 2004

with a market economy support the view that firms have the freedom to conclude contracts with whomever they want and for this reason, compulsory licensing is not a generally accepted legal norm. Secondly, there are different views on the circumstances where undertakings should be required to supply. There is also no uniformity on what constitutes an objective justification for not supplying. Thirdly, compulsory licensing can have different impacts on an economy and it may not be conducive to economic welfare, e.g. if ‘free riders’ exploit the benefits of other firms’ investments.<sup>1</sup>

The last point is particularly important for the issue of ‘essential facilities’ and particularly for the case *Microsoft vs. Commission*.<sup>2</sup> The expression ‘essential facility’ was introduced into EC competition law by Commission Decision in *Sealink/B&I-Holyhead*<sup>3</sup> in 1992. Mandatory access to a facility that is deemed to be essential for competitors to enter downstream markets is one of the main regulatory measures and antitrust remedies implemented worldwide and in Europe as well. This seems to have come about as a result of the liberalization of markets in network industries previously covered by publicly owned monopolists.<sup>4</sup>

The creation of a wholesale market for the facility in question is generally aimed in improving the extent of competition in downstream markets. A vertically integrated owner of essential facility is able to extend monopoly or dominant position to a downstream market, according to the degree to which the facility is somehow substitutable by other assets.<sup>5</sup> In the last fifteen years, the Commission has made extensive use of essential facility doctrine to introduce competition in markets where the existence of essential facility constitutes an insuperable barrier to entry. While this doctrine was

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<sup>1</sup> Whish, R., *Competition law*, 5<sup>th</sup> ed. ( UK: LexisNexis, 2003), p.663

<sup>2</sup> Case T-313/05, *Microsoft v. Commission*, [2005] OJ C257/16

<sup>3</sup> Commission Decision 92/34/174 *Sealink/B&I-Holyhead*, interim measures, not published. This case will be mentioned further in the paper.

<sup>4</sup> Armstrong, M., Cowan S., and Vickers J., *Regulatory Reform: Economic Analysis and British Experience*, (Cambridge: MIT Press, 1994)

<sup>5</sup> Castaldo A., Nicita A., ‘*Essential Facility and Efficiency in European Antitrust. Some Lessons from GVG/FS in the Railway Sector*’ [2005], May 31 2006, University of Siena, Faculty of Economics, available at <[www.unisi.it/lawandeconomics/simple/038\\_Castaldo\\_Nicita.pdf](http://www.unisi.it/lawandeconomics/simple/038_Castaldo_Nicita.pdf)>

initially applied to port infrastructures<sup>1</sup>, it has now been expanded to a large number of facilities such as telecommunications, electricity, gas, railways, the postal sector, oil and gas pipelines, airports, ground-handling services, set-top boxes, computer reservation systems, international networks for transferring payment messages, etc.<sup>2</sup> The circumstances in which a refusal to supply infringes Article 82 EC are controversial. This is even further complicated by different types of refusal to supply and because such refusals may take a number of different forms. In particular, a refusal to supply may be “unilateral” or “concerted”<sup>3</sup>; the refusal may be to supply a competitor or a customer who is not an actual or potential competitor. A refusal to supply a competitor may be a “first-time” refusal to supply<sup>4</sup> or may consist in the termination of an existing business relationship.<sup>5</sup> In each of these different situations an undertaking in question may refuse to supply, or it may make a “constructive” refusal to supply by an offer on very disadvantageous terms.<sup>6</sup> Moreover, a refusal may be a refusal to supply tangible products, to provide access to certain physical infrastructure, to provide services or to license intellectual property rights (IPRs)<sup>7</sup>. Many commentators criticize the law in this area as being uncertain, specifically lacking a proper conceptual

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<sup>1</sup> See Commission Decision 94/119/EC, Port of Rodby, (1994 O.J. L 55/52); Commission Decision 94/19/EC, Sea Containers/Stena Sealink, (1994 O.J. L 15/8); Commission Decision 92/34/174 Sealink/B&I-Holyhead, interim measures, not published.

<sup>2</sup> See Whish, R., supra 11.

<sup>3</sup> See *US v. Terminal Railroad* 224 U.S. 383 (1912); *Associated Press v. United States*, 326 U.S. 1 (1945), or collective boycott cases.

<sup>4</sup> See particularly Joined cases C-241/91P and C-242/91P, *Radio Telefis Eireann and others v. Commission (Magill)*, [1995] ECR I-743; Case C-7/97, *Oscar Bronner v. Mediaprint*, [1998] ECR I-7791; Case T-504/93, *Tierce Ladbroke SA v. Commission*, [1997] ECR II-923; Case C-418/01, *IMS Health v. NDC Health*, not yet reported; *Otter Tail Power Co. v. United States*, 410 U.S. 366 (1973); *Verizon Communications Inc. v. Law Offices of Curtis V. Trinko*, 540 U.S. 682, (2004)

<sup>5</sup> See Joined cases 6/73 and 7/73, *Commercial Solvents v. Commission*, [1974] ECR 223; Case 311/84, *Centre Belge d'Etudes de Marche-Telemarketing (CBEM) v. SA Compagnie Luxembourgeoise de Telediffusion (CLT) and Information Publiciti Benelux (IPB) (Telemarketing)*, [1985] ECR 3261; *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 472 U.S. 585(1985).

<sup>6</sup> See Commission Decision 2001/892/EC, *Deutsche Post- Interception of cross-border mail*, (2001 OJ L 331/40), para.141; and Commission Decision 1999/243/EC, *Trans-Atlantic Conference Agreement (TACA)*, (1999 OJ L 95/1), para.553

<sup>7</sup> Humpe, C. and Ritter, C., ‘Refusal to Deal’ (Global Competition Law Centre Research Papers on Article 82 EC, July 2005).

framework and economic rigour.<sup>1</sup> There is a necessity for clarity and legal certainty - rules must be predictable. This is a firmly established principle of the EC law.<sup>2</sup>

One of the questions relating to the extent to which dominant firms in possession of essential facilities (products or services) should be mandated to give access to these inputs to their competitors is of particular interest for the present paper. The problem is that there should be an economic response in deciding essential facility issues and, particularly, compulsory licensing. While granting access to “essential facilities” will stimulate competition in a secondary market<sup>3</sup>, it has the risk of reducing incentives for holders of essential facility. It also raises questions about the role of the competition authorities and the courts. Compulsory licensing involves complex price-related questions for which both the European Commission and the ECJ/CFI are poorly equipped.

### **C. Intellectual Property Rights and Competition Law**

The standard theory of interface between intellectual property rights and competition law is that:

“Both bodies of law share the same basic objective of promoting consumer welfare and an efficient allocation of resources. IPR promotes dynamic competition by encouraging undertakings to invest in developing new or improved products and processes. So does competition by putting pressure on undertakings to innovate. Therefore, both IPR and competition are necessary to promote innovation and ensure competitive exploitation thereof.”<sup>4</sup>

However, the common goal of economic efficiency does not preclude a certain tension between these two bodies of law. The grant of an intellectual property right may shackle competitive market processes. There are two forms of competition to be considered: product competition and research competition. The first one provides allocative efficiency and gives

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<sup>1</sup> Ibid.

<sup>2</sup> “[I]t is necessary to emphasize, as the Court has already done on several occasions, that Community legislation must be unequivocal and its application must be predictable for those who are subject to it.” Case 70/83, *Gerda Kloppenburg v. Finanzamt Leer (Kloppenbourg)*, [1984] ECR 1075, para.11

<sup>3</sup> By contributing to allocative efficiency

<sup>4</sup> Commission Notice - *Guidelines on the application of Article 81 EC to technology transfer agreements*, (2004/C 101/02)

consumers the opportunity to buy products at their market price. Research competition produces new products and technologies. This type of competition allows undertakings to escape from the constraints of product competition.<sup>1</sup>

A market economy does not necessarily provide an optimal amount of innovation. Granting the original inventor an exclusive right is viewed as an *ex ante* incentive to innovate by prohibiting free-riding. Thus, a grant of intellectual property right in the product market is part of a trade-off: “[a]like ordinary property rights that promote competition in production by preventing competition in consumption, intellectual property rights are a way (but not the only one) to promote innovation, by restricting some kinds of competition in production”.<sup>2</sup>

## II. European Case Law on Essential Facilities and Compulsory Licensing

Some of the most significant decisions of the European Commission and the Court of Justice should be mentioned in order to better understand the Commission Decision in *Microsoft*. Under the EC law the Court of Justice first dealt with refusals to deal in the case of *Commercial Solvents*.<sup>3</sup> In this leading case the Court found that under certain circumstances an undertaking in the dominant position had a duty to deal with another undertaking operating in a downstream market.

In *Magill*<sup>4</sup>, the Court had the opportunity to define the notion of abusive conduct. The Community Courts upheld the Commission’s finding that three television companies broadcasting programmes in the UK and Ireland

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<sup>1</sup> Aghion, P., Harris, C. and VICKERS J., ‘*Competition and Growth with step by step Innovation: An Example*’ [1997] European Economic Review, Papers and Proceedings, pp. 771-782. See also Encaoua, D. and Ulph, D., ‘*Catching-up or leapfrogging? The effects of Competition on Innovation and Growth*’ [2000] Cahier de la MSE, EUREQua, W.P.2000.97

<sup>2</sup> Vickers, J., ‘*Competition policy and innovation*’, [2001] Office of Fair Trading, Speech to the International Competition Policy Conference, Oxford

<sup>3</sup> Joined cases 6/73 and 7/73, *Commercial Solvents v. Commission*, [1974] ECR 223

<sup>4</sup> Joined cases C-241/91P and C-242/91P, *Radio Telefis Eireann and others v. Commission (Magill)*, [1995] ECR I-743

(BBC, ITP and RTE) had each abused an individual dominant position by refusing to make available details of their television schedules to a television listings magazine which would contain details of all three broadcasters' programmes. It should be noted that no such publication existed at the time.<sup>1</sup> This case required the owners of intellectual property rights to grant licenses of those rights to third parties or, in other words, it was a compulsory licensing case.<sup>2</sup> The Court of Justice held that the exercise of an exclusive right by its owner may, in exceptional circumstances, involve abusive conduct.<sup>3</sup> In this particular case, the abusive conduct emerged from the fact that the refusal to license prevented the emergence of a new product, this refusal was not objectively justified, and the broadcasting organizations reserved to themselves the secondary market of weekly television guides by excluding all competition in that market. In fact, access had been denied access to the basic information necessary for the compilation of such a magazine.<sup>4</sup> The basic idea of the case was that the mere exercise of intellectual property rights was not abusive in itself and an abuse could be found only in exceptional circumstances. However, the case law post-*Magill* was expected to clear uncertainty surrounding the scope of the Court's decision.

The next case is *Bronner*<sup>5</sup>. It is the most important decision concerning the conditions under which a dominant firm has a duty to provide access to an essential facility. It does not involve intellectual property issues but, nevertheless, it should be looked at as the Commission in *Microsoft* uses *Bronner* arguments in its decision. *Bronner* was a publisher of a daily newspaper and wished to have access to the dominant undertaking's (Mediaprint) highly developed nationwide home-delivery system for newspapers. *Bronner* complained that a refusal to allow such access amounted to an infringement of the Austrian equivalent of Article 82. The ECJ stated that "the mere fact that by retaining a facility for its own use, a dominant undertaking retains an advantage over a competitor cannot justify requiring access to it."<sup>6</sup> Mandatory access could be required and enforced only "where access to a facility is a precondition for competition on a

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<sup>1</sup> Whish, R., *supra* 11, page 665.

<sup>2</sup> It is an interesting case as compulsory licensing is more naturally a matter for intellectual property law than competition law.

<sup>3</sup> *Magill* at para. 50.

<sup>4</sup> *Ibid.* at paras 52-56.

<sup>5</sup> Case C-7/97, *Oscar Bronner v. Mediaprint*, [1998] ECR I-7791

<sup>6</sup> *Ibid.* at para 57

related market for goods or services for which there is a limited degree of interchangeability”<sup>1</sup> or in “the case where duplication of the facility is impossible or extremely difficult owing to physical, geographical or legal constraints.”<sup>2</sup> In the ECJ’s view, use of Mediaprint’s home-delivery service was not indispensable, since other means of distributing daily newspapers existed, e.g. shops, kiosks and by post. Furthermore, there were no technical, economic or legal obstacles to establishing another home-delivery system. Thus, in order to investigate whether an essential facility is in place, not only the market power of the owner of the facility in the upstream market should be considered.<sup>3</sup>

### **III. A Test to Distinguish Between Standard Refusal to Deal and Essential Facility Doctrine (EFD)**

One of the main lessons from US<sup>4</sup> and EU approaches to the essential facility doctrine is that in many cases a refusal to deal by a dominant firm could have been detected and sanctioned without any use of the essential facility doctrine. This could be seen in the decisions of *Kodak*<sup>5</sup>, *Lorain*<sup>6</sup>, *Otter Tail*<sup>7</sup> and *Aspen*<sup>8</sup> in the USA and *Telemarketing*<sup>9</sup>, *Commercial Solvents*<sup>10</sup> and *Sealink/B&I Holyhead*<sup>11</sup> in the EU. In these decisions refusal to deal identified a sudden change in a dominant firms' behaviour in supplying competitors. A sudden interruption of a previous way of dealing and refusal to supply competitors by a dominant firm could represent an important indication of a possible abusive strategy enacted by the dominant

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<sup>1</sup> Ibid at 61

<sup>2</sup> Ibid at 65

<sup>3</sup> See Whish, R. *supra* 11 page 673.

<sup>4</sup> See *Verizon Communications Inc. v. Law Offices of Curtis V. Trinko*, 540 U.S. 682, (2004)

<sup>5</sup> *Eastman Kodak Co. v. Image Technical Services, Inc.*, 504 U.S. 451 (1991)

<sup>6</sup> *United States v. Lorain Journal*, 342 U.S. 143 (1951)

<sup>7</sup> *Otter Tail Power Co. v. United States*, 410 U.S. 366 (1973)

<sup>8</sup> *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 472 U.S. 585(1985)

<sup>9</sup> Case 311/84, *Centre Belge d’Etudes de Marche-Telemarketing (CBEM) v. SA Compagne Luxembourgeoise de Telediffusion (CLT) and Information Publiciti Benelux (IPB) (Telemarketing)*, [1985] ECR 3261

<sup>10</sup> Joined cases 6/73 and 7/73, *Commercial Solvents v. Commission*, [1974] ECR 223

<sup>11</sup> Commission Decision 92/34/174 *Sealink/B&I-Holyhead*, interim measures, not published

firm, even if this strategy was in the form of a mere modification of previous commercial standards<sup>1</sup>. This could also be the case if there is a discriminatory refusal. It is very important to view such cases from the standpoint of an objective economic justification, e.g. the 1973 OPEC oil boycott.<sup>2</sup> If this is not the case, then it is possible that the refusal to supply strategy enacted by the dominant firm serves aims of anticompetitive pre-emption, market foreclosure, selective boycott and so on. It is clear from Article 82 EC that relevant market definition and the delineation of dominance should be correctly addressed. The dominant position should not be referred to the aftermarket where actually the firm has a monopolistic position, but to the primary market. When there is no dominant position in primary markets, refusal to deal in a secondary market may be aimed at improving the competitive race to the benefit of final customers by fulfilling intra-brand restrictions<sup>3</sup>.

For these reasons, unjustified and sudden refusal to deal could be a sufficient basis for detecting an abuse without invocation of essential facility doctrine. Imposing the remedy of mandating the continuation of supply to competitors, as was previously practiced by a dominant firm, or that of forbidding discrimination among clients, would not lead to any structural changes in the market and this need will endure as long as the dominant position of a firm-supplier persists. Thus, the test for essential facility should be drafted with respect to the above cases. In particular, the test should apply only when a refusal to deal is linked to an asset which has never been sold to competitors and for which there is no objective economic justification<sup>4</sup>.

Bearing in mind criteria elaborated in *Bronner*, a four-layer test may be used to determine EFD:

- i. Dominant position of the facility owner;
- ii. Feasibility of shared access;

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<sup>1</sup> Parcu P., 'The dominant position and its abuse: suggestions from game theory' [2004] Simple, Siena memos and Papers in Law and Economics, n.21

<sup>2</sup> Case 77/77, *BP v. Commission*, (1978) ECR 1513

<sup>3</sup> Castaldo, A. and Nicita, A., 'Essential Facility Access in US and EU: Drawing a Test for Antitrust Policy' [2005] May 31, 2006, available at SSRN: <<http://ssrn.com/abstract=877135>>

<sup>4</sup> Castaldo A., *supra* 15

- iii. Essentiality of the facility;
- iv. Non-duplicability of the facility.

The first requirement is an important one. It was remarked in the *Bronner* decision that if a facility is really essential then its owner will be a monopolist in the market for the facility. Hence the dominance requirement alone is not of high value for the test, what is really relevant is the power that access to the facility gives in a contiguous market, either upstream or downstream, where the owner of the facility operates<sup>1</sup>. So if there is a dominant position in that market then a refusal to deal or grant access to an essential facility may constitute a market foreclosure or a strategy of raising rivals' costs.<sup>2</sup> A good way to illustrate this is to deem essential facility an input, the access to which is essential to enter related markets. In the case where there is no dominance the access to essential facility is a non-existent problem, since there is no functional link between competition in the related market and access to that input. Thus, for a start, one should investigate the existence of a dominant position in a market (in which a product or service is offered) because of the access granted to an essential facility. In the cases of secondary markets or aftermarket a competitor in a secondary market may be granted access to the facilities necessary to operate if the owner of essential facilities is a dominant firm in the primary market.

The second step involves investigation of the feasibility of shared access. For example, not only the determination of a 'reasonable' price should be taken into account, but also the degree of rivalry in use of the facility determined by providing access to competitors. In other words, the application of a liability rule should not influence the sovereignty of the owner in a negative way; for instance the owner of the facility should not limit provision of goods or services to customers due to shared access.

The third step requires an analysis of essentiality of an asset. That means that there should be direct interrelationship between the market share and facility in question, e.g. having access to the facility dramatically affects the value of the final product or service generated through access. But even if an

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<sup>1</sup> Kahn A.E., 'Market Power Issue in Deregulating Industries' [1992] Antitrust Law Journal, vol.60, pp. 857-866

<sup>2</sup> Castaldo A., Nicita A., *supra* 50

asset is deemed to be essential for several reasons, it is not yet sufficient to impose mandatory access on an asset owner.

The last important condition is the non-duplicability of the asset. Non-duplicability may take different forms, such as non-duplicability because of physical restraints (absolute term) or market structure (relative term). The second form is of particular interest for the present research. Non-duplicability may be motivated by natural monopoly<sup>1</sup> but also by economic considerations of insufficient returns on investments directed at creating an alternative facility or service by a potential competitor. The latter condition is a complex one as it usually applies to cases where facility is not non-duplicable in a full sense, but the market structure is such that the dominant firm, which has already spent investments in creating the facility, may use, for example, supra-competitive margins to activate short term price wars.<sup>2</sup> In such situations, at least in the short term, the asset could be seen as being an essential facility. However, the Court in the *Bronner* decision disagreed and stated that not the start-up costs of a generic new entrant should be considered, but such costs should be parameterized to the minimum efficient dimension of a long-term operator in the market<sup>3</sup>. All this means that the Court will ascertain whether the new entrant is able to break even by replicating the asset. If it is the case and the entrant can cover its incremental costs, it will enter the market anyway either with the access to the input or without it. Hence, it is more economically profitable to grant an access to the existing facility and extract some of the efficiency gains than to face entry without extracting any benefit. For illustration purposes, suppose that there is a new entrant whose revenue would exceed the incremental cost for setting up the facility and provision of service. In such a situation, an incumbent would have an economic incentive to share his facility to get at least some money. Even in cases with natural monopolies<sup>4</sup> an asset will not constitute an essential facility if the cost of providing the service

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<sup>1</sup> See Braeutigam, R.R., *Optimal Policies for Natural Monopolies*, in *Handbook of Industrial Organization*, Volume 2, North-Holland, 1989; Sharkey W., *The Theory of Natural Monopoly* (Cambridge: Cambridge University Press, 1982)

<sup>2</sup> This may not necessarily be a predatory pricing but limiting pricing subject to the margins obtainable by new entrants investing in alternative facilities.

<sup>3</sup> Otherwise every entrant in any market should define incumbent assets as non-duplicable facilities.

<sup>4</sup> i.e. the average cost of providing the service using that asset declines over the whole range of output.

independently does not exceed the expected revenue from the additional downstream service. In such a case a mandatory access would produce an inefficient outcome<sup>1</sup>.

Where the above four steps are fulfilled, an asset is an essential facility. Denying access to it would constitute an infringement of Article 82 of the Treaty as it would harm consumer welfare by reducing the competitive race in related markets.

## II. The *IMS*<sup>2</sup> Judgment

Twelve years have passed since the *Magill* landmark initiative where compulsory licensing doctrine was applied. The *IMS* action before the ECJ arose from a complex factual and procedural history. It involved two parallel sets of proceedings. One, on intellectual property issues, was heard by the national courts of Germany, and another, on competition issues, was heard before the EC courts. As in *Magill*, the Commission was asked to intervene in *IMS* to moderate the otherwise fatal consequences of a dominant player's ability of invoking at an interlocutory stage an improbable national IP right, which is a copyright held by *IMS Health* in Germany in a database relating to pharmaceutical sales.

The European Court of Justice ruled on the preliminary reference case on April 29, 2004. The ECJ answered the following three questions asked by the Frankfurt District Court:

1. Is Article 82 EC to be interpreted as meaning that there is abusive conduct by an undertaking with a dominant position over the market where it refuses to grant a licence agreement for the use of a data bank protected by copyright to an undertaking which seeks access to the same geographical and actual market if the participants on the other side of the market, that is to say potential clients, reject any product which does not make use of the data bank protected by copyright because their set-up relies on products manufactured on the basis of that data bank?

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<sup>1</sup> Boldron F., Harington C., 'Vertical Relationship and Regulation: The Case of Essential Facility' [2001] *Revue Economique*, Vol. 52, No.3, pp. 655-664

<sup>2</sup> Case C-418/01, *IMS Health v. NDC Health*, not yet reported

2. Is the extent to which an undertaking with a dominant position over the market has involved persons from the other side of the market in the development of the data bank protected by copyright relevant to the question of abusive conduct by that undertaking?
3. Is the material outlay (in particular with regard to costs) in which clients who have hitherto been supplied with the product of the undertaking having a dominant market position would be involved if they were in future to go over to purchasing the product of a competing undertaking which does not make use of the data bank protected by copyright relevant to the question of abusive conduct by an undertaking with a dominant position on the market?<sup>1</sup>

Advocate General Tizzano<sup>2</sup> notes in his opinion in the *IMS* action that the first question supposes that IMS holds a dominant position in the market for pharmaceutical sales data and that the 1860 brick structure<sup>3</sup> is “essential” in order to operate in that market.<sup>4</sup> Assuming that both of these facts are correct, this question inquires whether the refusal to grant a licence of intellectual property would constitute a violation of Article 82 for the

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<sup>1</sup> Case C-418/01, *IMS Health v. NDC Health*, [2004] (Judgement of the Court of 29 April 2004) May 31, 2006, <[www.cr-international.com/docs/2004\\_ecj\\_judgment\\_health.htm](http://www.cr-international.com/docs/2004_ecj_judgment_health.htm)>. [hereinafter *ECJ Judgment of 29 April 2004*]

<sup>2</sup> The ECJ consists only of fifteen judges appointed by consensus among the Member States, but also of eight advocates general appointed by the Member States acting collectively, whose task is “to provide the Court with an impartial and reasoned submission on the cases before it so as to assist it in giving judgment.” Raworth, P., *Introduction to the Legal System of the European Union* 4<sup>th</sup> ed. (Oxford: Oceana Publications, 2001). “Advocates General are full members of the ECJ of equal status with the judges. Often their opinions provide fuller and more cogent reasoning, as they do not have to compromise. Independent judges, who never dissent or write individual opinions, may not be able to agree on the substance of their collegiate judgment but have to agree on its words, so much theory gets out, and even the minimum necessary to arrive at a result may be fudged.” Korah, V., ‘*Access to Essential Facilities Under the Commerce Act in the Light of Experience in Australia, the European Union and the United States*’ [2000] VUWLR 19

<sup>3</sup> *Supra* 63, at 20: The brick structure at issue in the *IMS* action includes the following data: postal codes of the German Post; political boundaries; the number of residents in each segment; the distribution of physicians and pharmacies; mapping information such as topographic data and street maps; and information regarding the regional organization of physicians’ billing associations.

<sup>4</sup> Case C-418/01, *IMS Health v. NDC Health* [2004] ECDR 9, para.29 (Opinion of Advocate General Tizzano Delivered on 2 October 2003) [hereinafter *Opinion of Advocate General Tizzano*]

dominant firm even if such a refusal does not restrict competition in a *separate market* [emphasis added] from that where the copyright holder uses its rights, but rather impedes potential competitors from operating in the *same market* [emphasis added] as the dominant firm.<sup>1</sup> Advocate General Tizzano further explained that the second and third questions asked by the Frankfurt District Court concentrate on one of the matters underlying the first question: whether the 1860 brick structure is indeed indispensable for competitors seeking to enter the German market for pharmaceutical sales data, such that IMS's refusal to grant licence would violate Article 82 of the EC Treaty.<sup>2</sup>

Considering previous case law on refusal to licence, and reiterating the way the Court in *Bronner* summarized *Magill*, the ECJ set out the legal standard as follows:

in order for the refusal by an undertaking which owns a copyright to give access to a product or service indispensable for carrying on a particular business to be treated as abusive, it is sufficient that three cumulative conditions<sup>3</sup> be satisfied, namely, that that refusal is preventing the emergence of a new product for which there is a potential consumer demand, that it is unjustified and such as to exclude any competition on a secondary market.<sup>4</sup>

The ECJ thereby defines a four-part test for when a refusal to licence constitutes an abuse:

1. The product or service protected by copyright must be *indispensable* for carrying on a particular business.
2. The refusal *prevents the emergence of a new product for which there is potential consumer demand*.
3. The refusal is *not objectively justified*.
4. The refusal is such as to *exclude all competition on the secondary market*.<sup>5</sup>

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<sup>1</sup> Ibid. at para. 30.

<sup>2</sup> Ibid. at para. 32.

<sup>3</sup> It should be noted that three above mentioned criteria were held to be cumulative for the first time in the IMS judgment.

<sup>4</sup> *ECJ Judgment of 29 April 2004*, para. 38.

<sup>5</sup> Killick, J., '*IMS and Microsoft Judged in the Cold Light of IMS*' [2004] *The Competition Law Review*, vol.1, issue 2

**Table 1: Exceptional circumstances in EU case law<sup>1</sup>**

	Magill	Bronner	IMS Health (cumulative conditions)
Indispensable input	X	X	X
Eliminating competition	X	X	X
New product	X		X
No objective justification	X	X	X

**III. Microsoft**

The latest case in the essential facilities saga is the *Microsoft* case. On March 24, 2004, after investigating for over five years a complaint by Sun Microsystems<sup>2</sup>, the European Commission concluded that Microsoft had violated Article 82 of the EC Treaty by refusing to license to rivals essential information on its Windows operating system. Sun Microsystems could not make Solaris, its work group server operating system, work with personal computers running on Microsoft’s operating system. To solve this problem Sun made a request to Microsoft for information on Windows’ interface, which the latter refused. Nevertheless, a fortnight after the Commission’s decision, Sun Microsystems and Microsoft reached a settlement to pay royalties<sup>3</sup> for each other’s technology and to make their operating systems software interoperable<sup>4</sup>.

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<sup>1</sup> Table is taken from Leveque, F., ‘*The Application of Essential Facility and Leveraging Doctrines to Intellectual Property in the EU: The Microsoft’s Refusal to License to Interoperability*’ [2004] Working paper, May 31, 2006 available at <[www.cerna.ensmp.fr/Documents/FL-Ms-WorldCompetition.pdf](http://www.cerna.ensmp.fr/Documents/FL-Ms-WorldCompetition.pdf)>

<sup>2</sup> This company alleged in February 1998 that Microsoft breached European Union antitrust rules by engaging in discriminatory licensing and by reserving to itself information that certain software products for network computing, called work group server operating systems, need to fully interact with Microsoft’s PC operating systems. This allowed Microsoft to leverage its dominant position in the PC operating system market to the work group servers market. Geradin D., *supra* 111

<sup>3</sup> Additionally, Sun Microsystems pocketed a sum of money four times greater than the Commission’s fine levied in its decision.

<sup>4</sup> Leveque, F., ‘*Innovation, leveraging and essential facilities: Interoperability licensing in the EU Microsoft case*’ [2005] Cerna, Centre d’économie Industrielle Ecole Nationale

## D. The Commission Decision<sup>1</sup>, March 2004

The Commission's decision in *Microsoft* was adopted a month before the ECJ decided the *IMS* case. The Commission has failed to take proper consideration of *IMS* action and, as a result, in the *Microsoft* decision the "exceptional circumstances" of *Magill* were not treated as exhaustive. As it was mentioned previously the Commission found Microsoft guilty of abusing its dominant position by failing to supply "interoperability information"<sup>2</sup>. The decision is constructed on the previous findings in statements of objections, such as that the interface information is essential<sup>3</sup>, its denial is a refusal to supply abuse<sup>4</sup> and the leveraging strategy constitutes an abuse<sup>5</sup>. The decision also had counter-arguments to issues of intellectual property raised by Microsoft.

In comparison with the three statements of objections, the Commission has taken some points and elaborated others. The Commission has considered non-disclosure of interface information<sup>6</sup> not to be a piece of a friend-enemy scheme but a general pattern. Thus, it abounded charges on abusive licensing and on discriminatory licensing. The decision on interoperability was restricted to a sole abuse, which is refusal to supply. At the outset, the Commission recognised that ordering Microsoft to disclose protocol

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Superieure des Mines de Paris, May 31, 2006, pre-print available at <[www.cerna.ensmp.fr/Documents/FL-Ms-WorldCompetition.pdf](http://www.cerna.ensmp.fr/Documents/FL-Ms-WorldCompetition.pdf)>

<sup>1</sup> Commission Decision C-2004/900, Case COMP/C-3/37.792 *Microsoft*

<sup>2</sup> Commission Decision, recital 546: "Microsoft is abusing its dominant position by refusing to supply Sun and other undertakings with specifications for the protocols used by Windows work group servers in order to provide file, print and group and user administration services to Windows work group networks, and allow these undertakings to implement such specifications for the purpose of developing interoperable work group server operating systems products."

<sup>3</sup> *Ibid.* at 692

<sup>4</sup> *Ibid.* at 545, 546

<sup>5</sup> *Ibid.* at 533 and 1063.

<sup>6</sup> Directive 91/250/EEC (1991 O.J. L 122/42- Software Directive)

specifications and allow third parties to use them<sup>1</sup> *may* [emphasis added] restrict the exercise of Microsoft’s intellectual property rights.<sup>2</sup>

## **Critical Consideration of Microsoft in the Light of the IMS Judgment**

*Microsoft* is inconsistent with *IMS* in several aspects. Firstly, the Commission failed to analyse whether the refusal to license prevented the “emergence of a new product for which there is unmet consumer demand”. The approach taken by the Commission is unpredictable and does not lay any particular test for future cases. Secondly, the *IMS* test of elimination of competition in a secondary market is differently applied in *Microsoft*. The Commission analyses “risk of elimination of competition” instead of whether the refusal to license was “likely to eliminate all competition”.<sup>3</sup> Lastly, the Commission has set a lower level of indispensability than in *IMS/Bronner*.

### ***i. Risk of Elimination of Competition***

The Commission has derived its “risk of elimination of competition” test from quotes from original judgments in *Commercial Solvents* and *Telemarketing*.<sup>4</sup> The Court in those cases did refer to “risk of elimination of competition”. Nevertheless it did apply a more stringent test, as the refusal to supply in both cases would have eliminated the complainant, as there was no substitute supplier: *Commercial Solvents* was the only supplier of the raw material in Europe and RTL was the sole francophone commercial TV station in Belgium. The refusal by those undertakings would have eliminated all competition in respective markets. Thus, in practical terms, the Court applies the same test as laid down in *Bronner*, *Ladbroke* and

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<sup>1</sup> *Ibid.* at 1004.

<sup>2</sup> *Ibid.* at 190, 546.

<sup>3</sup> The first one views at the market at some point in the future, while the second one is a more imminent test.

<sup>4</sup> Commission Decision, paras. 693-701. In *Magill*, *Commercial Solvents* and *Telemarketing*, one of the main elements of determining abuse was that the dominant undertakings’ behavior risked eliminating competition. See para 585: In *Bronner* it was clarified that, in order to rely on *Magill*, it was necessary to show that supply is indispensable to carry on business in the market, which means that there is no realistic actual or potential substitute.

*Magill*, i.e. that the refusal to supply was *likely* to eliminate *all* competition.<sup>1</sup> This is a more stringent test than a mere risk of eliminating competition. In the *IMS* Judgment, the Court stops at the “elimination of all competition” test and not at the “risk of elimination of competition”.<sup>2</sup> There is a substantial difference between these two conditions. In *Magill*, the refusal to license instantly eliminated all competition on the market: *Magill* was prevented from printing the second issue of its TV guide. In *IMS*, NDC was prevented from competing as it had no license to the “brick structure”. The refusal to license had near-instant effects on undertakings asking for it. However, in *Microsoft* rivals were able to compete for more than five years after the Commission found refusal took place.<sup>3</sup> On the basis of these considerations, it is seen that the *Microsoft* decision uses a lower test than the one laid down in *Magill* and confirmed in *IMS*.<sup>4</sup>

Moreover, in the *Microsoft* Decision, the Commission places “strong competitive disadvantage” on the same footing as “risk of elimination of competition”.<sup>5</sup> It states that “Microsoft’s refusal puts Microsoft’s competitors at a strong competitive disadvantage in the work group server operating system market, to an extent where there is a risk of elimination of competition”. It is clear that being at a strong competitive disadvantage does

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<sup>1</sup> *Bronner*, para 38: “Although in *Commercial Solvents* and *Telemarketing*, the Court of Justice held the refusal by an undertaking holding a dominant position in a given market to supply an undertaking with which it was in competition in a neighboring market with raw material and services respectively, which were indispensable to carrying on the rival’s business, to constitute an abuse, it should be noted that the Court did so to the extent that the conduct in question was likely to eliminate all competition on the part of that undertaking.”

<sup>2</sup> There are various formulations of this test in *IMS*. The Court recites *Bronner* at para 37: “likely to exclude all competition in the secondary market”; lays down its own test at para 38: “such as to exclude any competition on a secondary market”; para 47 speaks of “capable of excluding all competition”, while the operative part of the judgment says “reserve to the copyright owner the market ... by eliminating all competition on that market”.

<sup>3</sup> Microsoft faces significant competition. For example, Linux entered the market after the refusal and has grown its market share significantly.

<sup>4</sup> Killick, J., *supra* 68

<sup>5</sup> Commission Decision C-2004/900, Case COMP/C-3/37.792 *Microsoft* [ further: Commission Decision], at 589

not mean that competitors are immediately off the market (as happened with *Magill* and *IMS*).<sup>1</sup>

Overall, the Commission adopts a different and less strict approach than the *Magill* and *IMS* judgments. The decision is based on finding that the refusal to license would lead to a competitive disadvantage that risks eliminating competition. This test is speculative and much less immediate or direct than that in *Magill/IMS*; this is a long-term process likely to extend over the course of many years.

## *ii. Indispensability*

The Commission analyzes indispensability being linked with the question of whether competition would be eliminated. It uses the test of “realistic actual or potential substitutes” laid down in *Bronner*:

In *Bronner*, the Court of Justice clarified that, for the judgment in *Magill* to be relied upon, it was necessary to show that supply is indispensable to carry on business in the market, which means that there is no realistic actual or potential substitute for it.<sup>2</sup>

The Commission examines the level of interoperability existing on the market in order to assess indispensability. It admits that at Microsoft’s current level of disclosures there could be a degree of interoperability, which “is insufficient to enable competitors to viably stay in the market.”<sup>3</sup> This approach is different from that applied in the *IMS* Judgment that, in its turn, confirmed the test set out in *Bronner*. It is not required by EU law to grant optimal access to the market: “actual and potential alternatives” include even less advantageous facilities that exist and are used by

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<sup>1</sup> The Commission itself makes clear the difference among the conditions in its footnote (712) to the recital: “The present Decision does not purport to establish that competition is already eliminated in the market for work group server operating systems, or that it would be impossible to achieve even some partial interoperability with Windows client PC and work group server operating system (some partial interoperability is possible, not least due to previous disclosures made by Microsoft and due to the fact that Microsoft’s products are backward-compatible). However, it will be demonstrated that the degree of interoperability that can be achieved on the basis of Microsoft’s disclosures is insufficient to enable competitors to viably stay in the market.”

<sup>2</sup> Commission Decision, para. 585.

<sup>3</sup> Commission Decision, para. 712.

competitors.<sup>1</sup> In *IMS* the Court stressed that it is necessary to examine whether there are “alternative solutions, even if they are less advantageous”.<sup>2</sup> In *Microsoft*, the Commission admits that there are alternatives but they are so disadvantageous as to not in reality constitute alternatives.

So the question is whether the Commission has based its analysis on the correct level of interoperability. The Commission requires almost perfect “native” level of interoperability,<sup>3</sup> though it itself admits that interoperability is a matter of degree. In other words, different server operating systems may interoperate more or less well in practice. The Commission rejects open industry standards and reverse engineering as alternatives.

It is not disputed that competing server products are able today to interoperate with Microsoft products. In fact, some competitors have increased their market share. Thus, it seems that the Commission applied a higher standard for interoperability and a lower standard for indispensability than was applied in *IMS*. This is a dangerous step, as though in the short-term it may increase competition, in the long-term it may decrease incentives for a competitor to develop competing facilities and invest in Research and Development (R&D).<sup>4</sup>

### ***iii. Emergence of a New Product for Which There is Unmet Consumer Demand***

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<sup>1</sup> See Case T-504/93, *Tierce Ladbroke SA v. Commission*, [1997] ECR II-923, para 132, where Ladbroke argued when challenging the Commission’s refusal to act on its complaints about PMU’s refusal to give access to live footage that it was not possible to run a betting shop without live pictures. The Court rejected this argument finding that live video pictures were not indispensable and that their absence would not prevent bookmakers from pursuing their business. In particular, the Court noted that Ladbroke was present on the market and had a significant market position as regards bets on French races.

<sup>2</sup> *IMS* judgment, para 28

<sup>3</sup> Commission Decision at para 1003: “The objective of this Decision is to ensure that Microsoft’s competitors can develop products that interoperate with the Windows domain architecture natively supported in the dominant Windows client PC operating system and hence viably compete with Microsoft’s work group server operating system”.

<sup>4</sup> Opinion of Advocate General in *Bronner*, [1998] ECR I-7791, para 57

It is clear from *IMS* that a rightholder's refusal to license constitutes an abuse only when the undertaking reserves the secondary market to itself preventing the emergence of a new product. To get a license a company must "intend to offer new goods or services not offered by the owner of the right and for which there is potential consumer demand".<sup>1</sup> As noted above,<sup>2</sup> this test was not mentioned in *Bronner*, but it was restated in *IMS* in the same form as in *Magill*.

However, in the *Microsoft* decision this point is not addressed. The Commission does not provide any proof that as soon as Sun were to get a license it would offer a new product or service for which there was unmet consumer demand. Nor has the Commission shown that Sun ever informed Microsoft of its intention to offer a new product.<sup>3</sup> Quite the contrary, the Commission indicates that rivals need the interface information to compete directly with Microsoft.<sup>4</sup> The Commission identifies neither any new product nor unmet consumer demand. The closest it gets is when it speaks about competitors being "discouraged from developing new products"<sup>5</sup> and competitors indignant in the interface information from bringing "innovative work group server operating system features" to the market<sup>6</sup>. The Commission just shows that competitors would be able to improve the existing products, instead of showing that there would be new products. This test would be satisfied in almost every case involving valuable intellectual property – the rivals would be able to use the information to improve their own products.

#### *iv. Conclusion on Microsoft and IMS*

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<sup>1</sup> *IMS* judgment, para 49

<sup>2</sup> See *IMS, Bronner*

<sup>3</sup> The decision didn't find that Sun told Microsoft when it asked for the licence that it was going to use the technology to create new products. Microsoft had no reason not to assume that Sun was going to use the technology to offer only a directly competing product.

<sup>4</sup> Commission's Decision, para 1003: "The objective of this Decision is to ensure that Microsoft's competitors can develop products that interoperate with the Windows domain architecture natively supported in the dominant Windows client PC operating system and hence viably compete with Microsoft's work group server operating system."

<sup>5</sup> *Ibid.* para 694

<sup>6</sup> *Ibid.* para 694-695

What is clear after the *IMS* judgment is that the court will not hesitate to mandate compulsory licensing on an undertaking abusing its dominant position providing that certain conditions are met. The Court accepts compulsory licensing being appropriate even in cases with new economic industries involving intellectual property rights, which rely on intellectual property rights to stimulate innovation and in research and development. The *Microsoft* action pending before the EC courts is such a case. If the EC courts agree with the Commission's arguments that Microsoft's refusal to license its interoperability information impedes the appearance of a new product, excludes all competition in a secondary, downstream market and lacks any objective business justification, the courts will uphold the Commission's compulsory licensing order in this action. The *Microsoft* decision applies a legal standard on compulsory licensing that significantly differs from the test set out in *Magill* and *IMS*. If it is upheld on appeal, the decision would considerably loosen the circumstances where a compulsory licensing would be ordered. Additionally, a considerable degree of uncertainty would appear because of such a test.

\* **Editor's remark.** The article *Intellectual Property Law vs. Essential Facility Doctrine. Microsoft vs. Commission* by Arutyun Arutyunyan represents the best traditions of the student research. In late 2006 his Bachelor thesis with the same title received *Gerbert Rüf Stiftung's* Swiss Baltic Net Graduate Award to encourage the young researchers, graduates of Baltic universities. Since the publication of the articles by Swiss Baltic Net Graduate Award winners has become a good tradition in IUA, the editorial board of the current collection asked him to write a conclusive article on the same topic. In late June 2007 we received the article by Arutyunyan, which was actually the very first contribution submitted. However, in September 2007 the European Court made its decision in this case, against some of the author's arguments and expectations. Nevertheless, the editorial board of the collection decided to publish the article unaltered, because it gives a brilliant analysis of the circumstances prior to the court's decision and reflects some fundamental controversies between the principles of competition and intellectual property laws.

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