OPINION

Compulsory Access Under EC Competition Law—A New Doctrine of "Convenient Facilities" and the Case for Price Regulation

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Two recent Art. 82 cases—the European Court of Justice ("the ECJ") judgment in the *IMS Health* case and the Commission decision in the *Microsoft* case—have re-ignited an old debate on the use of competition law to oblige dominant firms to share their assets with rivals.[1] These cases provide a fresh chance to consider the economic principles behind the use of EC competition law in this area, and to identify the gaps that remain in the analytical framework.

There are two central questions underlying any case in which a dominant firm is obliged to share its facilities with rivals in the name of competition law. First, under what circumstances should such compulsory access be granted? Secondly, where the conditions for compulsory access are satisfied, on what terms should access be granted?

The *IMS* and *Microsoft* cases deal at some length with the first of these questions, but scarcely if at all with the second. Both cases deal with access to intellectual property: the copyrighted German "brick structure" in the *IMS* case; and the interoperability information between the Windows PC operating system and work group server operating systems ("server software") in the *Microsoft* case.[2]

When should compulsory access be granted?

In the *IMS Health* judgment, the ECJ concluded that refusal to supply a copyright licence to a potential licensee would be an abuse where *all three* of the following conditions held:

- The need for licensee innovation: the licensee must be proposing to offer a new product, not just a "me-too" version of the dominant firm's product;
- The absence of an objective justification: refusal may be justified if "objective considerations" tell in favour of doing so; and
- Elimination of competition: the refusal must have the effect of "eliminating all competition" from the downstream market.

The first of these conditions—the need for licensee innovation—owes much to the legacy of the Magill TV listings case, where the copyright holders' refusal to license weekly TV guides suppressed the development of any publication containing comprehensive week-ahead TV listings.[3] Interestingly, this condition has no analogue in the essential facilities cases that involve physical property rights. For example there was no obligation on Irish Ferries to offer a faster or different service from Holyhead to Dublin than had been offered by the integrated port and ferry operations of Sealink.

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1 For *IMS,* see ECJ Judgment C-418/01 *IMS Health,* April 29, 2004, and also the two Commission Art.82 decisions on interim measures, *National data services v IMS Global Services* Case No.COMP/38.044, July 3, 2001 and August 13, 2003. For *Microsoft,* see Commission decision *Microsoft/Windows 2000* Case No.COMP/37.792, March 24, 2004.

2 However, the issues discussed in this article are not specific to intellectual property cases.

3 The two copyright owners in UK TV listings, BBC and ITP, at that time produced separate listings magazines for the respective programmes broadcast by BBC and ITV.

Moreover, it is hard to see how this condition has any solid economic foundation. It would be trivially easy for NDC, the main potential licensee in the IMS case, to implement some product change that rendered its market research product "innovative" relative to that of IMS. In any event, it is hard to see a justifiable public policy rationale for this condition. If it was established that foreclosing competition allowed IMS to sustain an inefficient and abusive outcome on the market for pharmaceutical market research products, then the public policy case for allowing NDC to enter the market through compulsory licensing of the brick structure is valid even if the only "innovation" provided is a competitive price. But if the view is taken that the IMS offering was competitive, it is hard to see what role there is for intervention to force innovation through compulsory licensing, since IMS would have a normal commercial motive to boost demand for its product by promoting innovation itself.[4]

As regards "objective justification", the ECJ leaves it to the national court that referred the case to determine how to interpret this condition. It is again hard to define any economic criteria that would give operational value to this condition. In a physical property case such as access to a port, perhaps evidence that the port had no spare capacity might suffice, but where intellectual property is concerned there can be no such thing as a capacity constraint. To the extent that "objective justification" refers to the property owner's right to a fair return on its investments, this issue is discussed further below in the context of access pricing.

The third ECJ condition, relating to the elimination of competition, lays down an understandably tough condition that seems consistent with the concept of an essential facility as it is generally understood. The exception to the normal respect for property rights can kick in only where some chronic failure of competition has been identified. In the *IMS* case, whether this condition is met rests on one's view on the ability of NDC or other competitors to "invent around" the IMS brick structure and to persuade customers in Germany to buy pharmaceutical market research products that adopt a different geographical segmentation than the IMS brick structure they had been accustomed to using.[5]

If we then turn to the Commission's approach to compulsory access in the *Microsoft* decision, it is fascinating to note that a completely different standard appears to have been applied.[6] Here, the issue concerns the provision of interface information that will allow server software supplied by Sun and others to operate seamlessly with Microsoft's ubiquitous Windows PC software. It is evident from the market facts as reported in the decision that Microsoft's refusal to supply this interface information has not "eliminated all competition" from the secondary market for server software, even if it has given Microsoft a competitive advantage. Microsoft's share of the relevant server software market was estimated at around 60 per cent, with various rival suppliers enjoying shares between 5 per cent and 15 per cent.

Instead of adopting the ECJ's essential facilities check list, the Commission decision has taken an altogether more open-ended approach in which it reserves the right to consider the costs and benefits of mandating access, given the facts surrounding the case. This could be characterised as a move towards a new "convenient facilities doctrine" (an asset without access to which it would be jolly inconvenient for rivals because they would need to offer customers a better product in order to overcome the advantages of the incumbent).

It is very hard to see how this "convenient facilities" approach can be reconciled with the ECJ's *IMS* judgment. Conceivably, one might argue that, taking an appropriately dynamic view of the market, and in view of the tendency for some high tech markets to "tip", failure to provide access to interoperability information today will condemn the server software market to near-certain monopolisation by Microsoft in the foreseeable future. If this outcome can be forestalled only by prompt action today, then it is just arguable that the alternative to intervention today is indeed the "elimination of all competition" that is laid down as a requirement in the *IMS* judgment. But to reach that conclusion requires some heroic leaps in the empirical analysis as well as some elastic manipulation of the legal concepts.[7] Presumably the arguments in the Microsoft appeal will tread this ground.

Is the "convenient facilities" approach justified in economic terms? This is a separate and in some ways even more difficult question that echoes a timeless debate in the economic literature on the optimal envi-

4 In fact, it is evident from the Commission decision that IMS did allow its product to interface with a variety of third party market research and software providers who provided product enhancements for the ultimate clients.

5 The Commission's decision of August 2003 notes that NDC had indeed managed to develop an alternative brick structure and to sign up a number of major clients. The facts surrounding this invention, and the question of whether the NDC brick structure itself infringes the IMS copyright, remain somewhat obscure.

6 The Commission's decision on *Microsoft* was produced just days in advance of the ECJ's *IMS* ruling.

7 The debate here closely follows the discussion on the use of exclusionary effects theories in merger cases such as *GE v Honeywell* and *TetraLaval v Sidel.*

ronment for innovation. We know that a firm with unconstrained monopoly power is likely to be too lazy to innovate, and that a firm with no prospect of attaining a degree of market power cannot expect to generate the funds to finance worthwhile investments in innovation. Somewhere between these unhelpful extremes lies the optimal degree of protection that balances the benefits of rivalry and competition against the need to provide incentives to innovate.

In advocating a grand cost-benefit assessment under the convenient facilities doctrine, the Commission has in effect staked a claim to know where to draw this line. In doing so, it appears to have departed from the "last resort" intervention philosophy of the essential facilities cases, and has instead adopted a micromanagement approach, whereby the competition authority is presumed to have the ability to identify the right balance between the benefits of creating incentives for winners, and the benefits of competitive rivalry. No one can say definitively that this is wrong as matter of economic or industrial policy, but one must wonder whether the Commission is really capable of making this key judgment.[8]

How should compulsory access terms be determined?

In both the *IMS* and *Microsoft* cases, very little has been said about the terms on which access should be provided.

In the *IMS* case, the original decision of the Commission stated only that IMS should license the German brick structure on terms that are reasonable and non-discriminatory. The decision left it to the parties to reach "mutual agreement" on the prices that would meet these criteria, and suggested that an independent expert should be appointed to adjudicate the result in the event that agreement was not reached.[9]

In the *Microsoft* decision, the Commission has also decreed that licensing of the interoperability data should be done on terms that are reasonable and non-discriminatory, and has further added that Microsoft's remuneration from the licensing "should not reflect the strategic value stemming from Microsoft's power in the client PC operating system market or in the work group server operating systems market".[10]

These criteria seem unexceptionable, but when one comes to turn them into operational outcomes—actual numbers on how much licensees must pay—it soon becomes apparent that they leave many critical questions unanswered. Moreover, the factors that are missing reveal important gaps in the economic analysis that lies behind the decision to intervene in these markets.

The "reasonableness" criterion that appears in many Commission statements is almost completely devoid of meaning. Experience shows that the terms on which compulsory access should be granted is a subject on which reasonable people can, and invariably do, disagree.

The non-discrimination principle has somewhat more content, though it is still hugely open to interpretation. In practice, the principle of non-discrimination can be used to achieve two different objectives. Most straightforwardly, it can be used to ensure that licensing terms do not create downstream distortion between competing licensees. In some cases it is also possible to use non-discrimination as an indirect means to regulate the level of prices for compulsory access. Where a licensee already exists it is sometimes argued that the terms of that existing licence provides a valid "benchmark" for the competitive level. Where there is no existing licensee, the terms offered to licensees by the dominant firm can be compared with the retail price offered by the dominant firm as a prelude to conducting a margin squeeze analysis.[11]

It is, however, unlikely that these fragments can be pieced together to create an operational guide to access price setting. Given the presence of price discrimination in most competitive markets, the whole concept on non-discrimination as a property of competitive market solutions is a misconception, but nowhere is that misconception more evident than in intellectual property licensing. For one thing, there are no (marginal) costs incurred by the licensor when granting a licence, and so it becomes impossible to define price-discrimination (variable price-cost margins) in all but the most simple cases. More generally, however, intellectual property licensing in competitive situations is in practice little more than an exercise in price discrimination, since

8 One must also wonder whether it can be justified to fine a dominant firm for not having anticipated the regulator's view on such a fine and subjective judgment.

9 No such agreement was reached, and the case proceeded via other legal routes such that the arbitration process envisioned by the Commission did not come into play.

10 *Microsoft* decision, para.008(ii). A number of other criteria are also listed, for example on timeliness and robustness to future situations, but these do not relate directly to the level of prices.

11 Simplistically, if the dominant firm's own retail business could not afford to pay the proposed licence fee (assuming its downstream operation was obliged to be financed independently of the licensor operation), it could be argued that the proposed fee must be too high since no efficient licensee business could survive at that level of cost.

typical licence structures such as user, or royalty, related fees are set so as to reflect demand-side considerations of the value of the intellectual property to the licensee, and bear no relationship to the costs incurred by the licensor.

Where competition laws are used to impose compulsory licensing it is common for reluctant licensors to claim that the licensing rates should be set such as to compensate them for the loss of profits they suffer as a result of admitting the licensee as a competitor in the downstream business (the principle of "no confiscation"). This issue highlights the lack of completeness in the analysis of the typical essential facilities case.

This situation was clearly illustrated by the Copyright Tribunal ("CT") proceeding that followed the *Magill* ECJ ruling on TV listings. In the absence of any pronouncement by the ECJ on the question of pricing, the CT was left to play the role of price regulator. BBC and ITP (the copyright owners) set out the principle that they should gather licensing revenue that compensated them for the anticipated lost profits in their respective TV listings magazines. The prospective licensees, however, noted that the value to the copyright holders was due precisely to the monopoly they enjoyed in their respective listing magazines and that this value would disappear as soon as the market was served by a number of competing listings publications.[12] The CT resolved this dispute in a way that favoured the licensees, and that therefore involved a substantial degree of confiscation of the profits earned by the licensors.

In the IMS case, the Commission's interim decision evaded any explicit pronouncement on whether, having excluded competition though its refusal to license its brick structure, IMS had charged excessive prices for its market research products. Implicitly, however, the Commission seemed to assume that competition from multiple licensees of the IMS brick structure would facilitate competition and lower prices. The result was a stalemate between a licensor that sought to set a price level which would avoid any confiscation of its pre-licensing profits, and licensees who would naturally argue for a price that reflected no more than the (relatively small, and historic) costs incurred by IMS in creating the brick structure. The former criterion will almost inevitably set price at a level that is too high to be commercially attractive to licensees, whilst the latter would amount to substantial confiscation of the value of the intellectual property right. Depending on the facts, neither of these outcomes is definitively wrong in public policy terms, but the Commission's decision provided no framework within which to assess how to reach the appropriate outcome.[13]

In the Orders accompanying the *Microsoft* decision, the Commission has made some, albeit still inadequate, steps towards specifying the access-pricing regime more fully. By inserting the "no strategic valuation" criterion alongside the usual language of reasonableness and non-discrimination, the Commission implies that Microsoft should not be allowed to set licensing terms such as to protect the existing monopoly rents from its dominant position in the PC and server software markets.

Suppose, for example, we could somehow determine that the prices charged by Microsoft for its server software were 40 per cent above the competitive level. When granting licences to competing server software suppliers for its PC software interoperability facility, one factor that Microsoft would normally take into account would be the loss of profits its server software business would suffer as a result of the increased competition in the server software market that would be caused by the granting of the licence. In this scenario, the Commission's ban on "strategic" valuations would mean that Microsoft would need to change its licensing criteria so as to disregard 40 per cent of the harm that licensees would do to its own server software business. The rationale would be that this element of profit should not properly belong to Microsoft, and that taking it into account would perpetuate the existing monopolistic market outcomes.[14]

In short, in order to interpret the "no strategic value" criterion it would be necessary for the Commission to specify how far Microsoft's current prices are above the competitive level. Unsurprisingly, however, in view of the foregoing discussion, there is nothing in the 300 pages of the Commission's decision that would allow the reader to derive this key piece of information. Once

12 This is not to say that such magazines could not make a profit if they provided content and commentary for which a demand existed. But as soon as week-ahead TV listings information became readily available from multiple sources, no publication could hope to achieve any differentiation or derive commercial value from the listings *per se.*

13 As is noted above, the decision did naively hope that the parties would reach a mutually agreed price, and, failing that, put in place an arbitration process. But the task of the appointed arbitrator would have been impossible without some kind of pronouncement from the Commission on what level of confisca tion was appropriate.

14 In reality, the actual calculation would be immensely more complex than the one described in this simply hypothetical. First, the Commission's criterion requires that Microsoft disregard both the excess profits in both the PC and server software elements of its business. Secondly, given the importance of dynamic considerations in the computer software sector, the consideration of strategic factors would need to take into account both today's profits and the extent to which Microsoft's current practice was predicated on the pursuit and protection of future excess profits.

again, therefore, the Commission's silence on the level of prices represents a gap in the analysis.

Conclusions

The question of when and in what circumstances the owner of an asset should be obliged to share it with competitors in the name of competition law has always been controversial, and will remain so. The substantive guidance given on this point from the ECJ's judgment in the *IMS* case is very limited. However, the Commission's decision in the *Microsoft* case, regarding the compulsory licensing of interoperability information in the PC/server software market, creates a new level of uncertainty on EC competition law enforcement. By requiring compulsory access to a facility without which it is *inconvenient* (rather then *essential)* for rivals to do business, the Commission has in effect declared an ability to micro-manage competition in a way that goes well beyond the "last resort" intervention that normally characterises compulsory access cases.

As regards the terms on which access should be granted, the harsh lesson from the existing cases is that proper resolution of an essential facilities case requires price regulation on the monopoly facility of a kind similar to that which is used to regulate natural monopoly utility networks such as private water companies or gas transmission companies. A requirement to grant access without specifying the terms of access leaves the problem only part-resolved. Critics of intervention rightly argue that such regulation should be confined to cases where there has been an extreme and chronic breakdown of the competitive process, because of the likelihood that such regulation will do more harm than good. Competition authorities are right to shy away from such hands-on regulation of price levels, but for that same reason they should also be less quick to declare the existence of an essential facility or the need for compulsory access terms.