



# Tying/bundling



# Tying/bundling

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- Article 102(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”
  - Can take place on a technical or contractual basis
- Definitions
  - Contractual tying: specified by contract – *Hilti*
  - Withdrawal / withholding warranty: warranty only valid if customer uses a supplier’s components – *Hilti*
  - Technical tying: product is physically integrated – *Microsoft*
  - Pure bundling: only possible to purchase the two products together
  - Mixed bundling: products sold separately, but cheaper when bought together

# Why does tying and bundling raise competition issues?

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- Leverage of dominant position in one market (the “tying” market) into another market (the “tied” market)
  - Key question - when are the bundled / tied products regarded as distinct products or a single system
- Tying allegedly used to reduce competition in the potentially competitive “tied” market
- But tying and bundling can have pro-competitive effects



Hilti



**BP** BERWIN  
LEIGHTON  
PAISNER

# Tying

## Hilti – Facts I

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- Hilti AG – manufactured:
  - nail guns; and
  - cartridge strips, cartridges and nails (“consumables”)
- Rival nail producers were able to produce nails that worked in Hilti machines BUT were not able to produce cartridge strips
- Hilti wanted to ensure that customers who purchased cartridge strips bought Hilti nails for use in those cartridges

# Tying

## Hilti – Facts II

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- Hilti only supplied customers with cartridge strips if they also purchased nails for use in the cartridges
- Special discounts for the combined purchase of nails and cartridge strips
- Refused to supply competing nail producers with cartridge strips
- Took steps to prevent customers and its distributors from supplying cartridge strips to other nail suppliers
- Refused to honour its guarantee for the tools if they had been used with non-Hilti consumables

# The Commission's case (i)

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- Three distinct product markets
  - nail guns;
  - Hilti-compatible cartridge strips; and
  - Hilti-compatible nails.
- Hilti was dominant in all three relevant markets.
- Commission argued that tying the sale of cartridge strips to the sale of nails constituted an abuse of Hilti's dominant position
  - Consumer left with no choice over the source of their nails
  - Hilti's actions abusively exploited customers.
  - Hilti's policies all have the object or effect of excluding independent nail makers who may threaten the dominant position Hilti holds

## The Commission's case (ii)

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- Is the restriction of a guarantee an abuse?
- Commission's view:
  - *"Whilst it may be legitimate not to honour a guarantee if a faulty or sub-standard non-Hilti nail causes malfunctioning, premature wear or breakdown in a particular case, such a general policy in the circumstances of this case amounts to an abuse of a dominant position, in that it is yet another indirect means used to hinder customers from having access to different sources of supply."* Eurofix-Bauco v. Hilti, Commission Decision 88/138/EEC, 1988 O.J. (L 065) 79



# Objective justification?

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- Hilti claimed that tying the sale of its nail guns to the sale of its nails enhanced the safety and reliability of the overall fastening system.
- The Commission rejected Hilti's justification on a number of grounds, focusing predominantly on the safety aspects:
  - The Commission regarded the existing safety controls and standards in the EU as adequate safeguards rendering Hilti's argument concerning safety invalid. *Eurofix-Bauco/Hilti, para 75*
  - The Commission argued that tying was not the least restrictive action necessary to attain the object of safety and that Hilti's behavior was not solely motivated by concerns over safety and reliability. *Eurofix-Bauco/Hilti, para 75*
  - The Commission argued that Hilti had "not been able to show any evidence of accidents to operators as a result of the use of these millions of nails produced by [Hilti's competitors]." *Eurofix-Bauco/Hilti, para 93*
- Hilti appealed to the Court of First Instance, which upheld the Commission's decision. A further appeal by Hilti to the European Court of Justice was also unsuccessful.



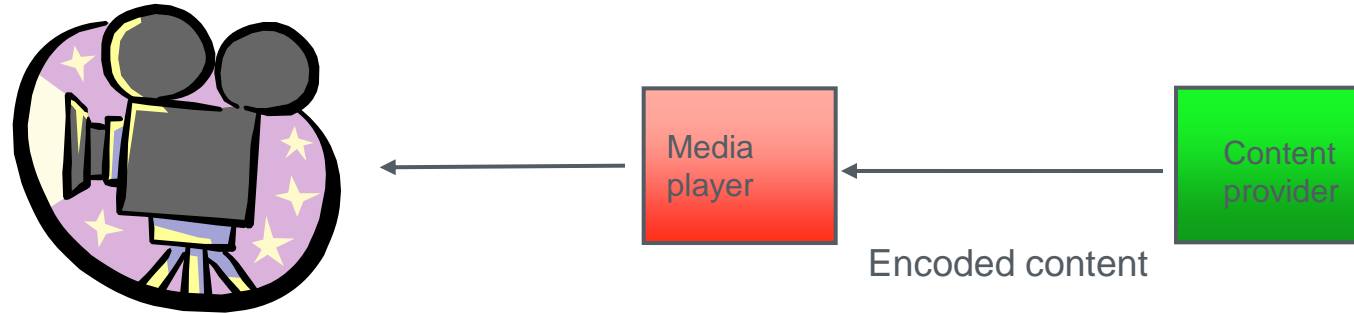
## Microsoft – Windows Media Player (“WMP”)



# Tying

## Microsoft: Facts (i)

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- Microsoft produces Windows PC operating system and Windows Media Player (WMP)
- WMP allows PC users to play audio and video files stored on the PC or downloaded from the internet in real time (called “streaming”)
- Microsoft supplies WMP in competition with other firms such as Real-Networks and Apple
- For the media files to function, the media player must have the relevant compression and digital rights management (DRM) protocols available.
- Media player software is usually supplied to individual PC users for free and the makers of media player software earn revenue from:
  - sales of premium versions of the player;
  - sales of content from online music stores; and
  - supplying recording and server software to content owners and providers.

# Tying

## Microsoft (WMP) – Facts (ii)

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- Relatively costly for content providers to encode in multiple formats – they prefer to make content available only in the most popular formats
- In 1998 Microsoft released a media player that supported streaming from the internet and multiple formats and supplied this as a separate application
- In 1999 Microsoft:
  - Integrated WMP into Windows Operating system; AND
  - WMP included its own proprietary DRM technology and no longer supported other companies' formats.

# Harm competition?

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- Anti-competitive effects
  - Tying can exclude single product suppliers (Windows + WMP v. Realplayer / Adobe / Apple)
  - Markets tip to a single standard, tying can extend a monopoly (Content providers only produce WMP material)
  - Tying can be used to protect a monopoly position (WMP used to prevent rivals gaining foothold)

# Benefit competition?

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- Pro-competition arguments
  - Tying can be used to protect reputation – technical interoperability of WMP with windows
  - Customers want it (as shown by the failed remedy too)
  - Benefits of enhanced media capability vs. possible future harm?
  - New competitors – Adobe, changing market conditions and no lock-in /coercion
  - Fast moving markets – very hard for competition authorities (and companies!) to predict the future

# The legal test

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- Four elements:
  1. Distinct product markets
    - Demand for “tying” product without “tied” product? E.g. shoes without laces / cars without tyres / Windows without WMP (or Internet Explorer)
  2. The undertaking is dominant in the tying market;
  3. Consumers are not able to obtain the tying product without the tied product;
  4. Competition is foreclosed
    - are third-party media players excluded?
- Unless objective justification
  - Efficiencies? Technical benefits?

# The Commission's decision/CFI's view

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- CFI endorsed the Commission's four-part test for abusive tying:
  - tying and tied products are separate
    - Separate demand for Windows and WMP ✓
  - undertaking is dominant on the market for the tying product
    - Microsoft dominant – PC O/S ✓
  - customers do not have a choice of obtaining the tying product without the tied product
    - Windows only available with WMP ✓
- Does this practice foreclose competition?



# Commission's three-stage foreclosure argument

1. WMP “unparalleled presence” on PCs – other distribution methods (agreements with OEMs/downloads) less efficient than tying with Windows
2. Ubiquity of WMP = software developers focused development efforts on WMP
3. Result of 1 + 2 led to an increase in WMP's market share and a decrease in rivals market share

# Microsoft's response

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- Foreclosure not mentioned in Art 102(d) – Commission's analysis added a "new highly speculative theory"
- Actions taken to ensure other media players would function effectively within Windows
- OEMs were free to install competing players (as were consumers)
- On average users installed more than one media player

# Foreclosure of competition

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- The CFI held that Microsoft:
  - obtained *"an unparalleled advantage with respect to the distribution of its product"*
  - used the bundle to ensure *"the ubiquity of WMP on client PCs"*
  - created a *"disincentive for users to make use of third-party media players and for OEMs to pre-install such media players on client PCs"*
  - weakened competition so that the maintenance of an effective competitive structure would not be ensured in the near future (para 1054)
- Forward looking theory of foreclosure?
  - "[T]here was a **reasonable likelihood** that tying Windows and Windows Media Player would lead to **a lessening of competition so that the maintenance of an effective competition structure would not be ensured** in the foreseeable future." (para 1089)

## CFI's comments – effects based analysis

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- “[T]he fact that the Commission examined the **actual effects** which the bundling had already had on the market and the way in which that market was likely to evolve, rather than merely considering that the tying has by its nature a foreclosure effect, does not mean that it adopted a new legal theory.” (para. 1035)

- No need to go to the content argument:

“[T]he Commission’s findings ... are not based on any new or speculative theory, but on the nature of the impugned conduct, on the conditions of the market and on the essential features of the relevant products. They are based on **accurate, reliable and consistent evidence** which Microsoft, by merely contending that it is pure conjecture, has not succeeded in showing to be incorrect.” (para. 1058)

# Objective justification?

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- Microsoft claimed three related efficiencies justified the tie
  1. Integration of new functions was part of its Windows business model – more useful and attractive platform for developers and results in lower consumer transaction costs.
  2. Integration of WMP enabled developers, content providers and consumers to rely on standard media functionality being available.
  3. Removing WMP would damage the performance of Windows

# CFI Response

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1. Efficiencies could be achieved without tying: consumer demand for preinstalled media players would be satisfied by OEMs installing one prior to delivery
2. “Standardization” – not an efficiency, but the competition problem it sought to address, the CFI held that:
  - *“The fact that tying enables software developers and Internet site creators to be sure that Windows Media Player is present on virtually all client PCs in the world is precisely one of the main reasons why the Commission correctly took the view that the bundling led to the foreclosure of competing media players from the market. Although the uniform presence to which Microsoft refers may have advantages for these operators, that cannot suffice to offset the anti-competitive effects of the tying at issue.”* (para 1151)
3. Insufficient evidence to support Microsoft’s claim that the technical performance of Windows would be degraded by removing WMP

# Remedy issues

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- Microsoft ordered to offer PC manufacturers a version of its Windows PC OS without Windows Media Player (XP-N)
- Microsoft remained free to offer a version including Media Player free of charge, but could not:
  - Offer terms making the unbundled version less attractive
  - Offer discounts conditional on purchasing the combined package
- Query remedy result:
  - First commercial product designed by an antitrust authority
  - 1700 copies of Windows XP-N sold in Europe during first nine-months after offered vs. 35.5m Windows XP sold
  - Pricing same for both products – would you buy WP-N?
  - Does failure of remedy affect underlying case?



# Summary of pro/anti-competitive issues



# Pro-competitive effects

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- **Reputation effect**
  - Tying can be used to ensure product performance and protect reputation
    - Tying can ensure product performance/manufacturer's promises
    - Product warranty issues
- **Lowering cost/price, increasing demand**
  - Tying can reduce costs and enhance efficiencies for producers
  - Tying can reduce consumer's costs (e.g., integration)
  - Some cases tying results in lower price for durable good (e.g., games console), resulting in increased sales of consumables (e.g., games)
- **Competition in bundles can be very strong**
  - Failing to make sale leads to the loss of two margins
  - Can lead to lower prices – benefiting consumers

# Anti-competitive effects (i)

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- **Soften price competition**
  - Single product suppliers have less incentive to cut prices when facing bundled competition
  - Bundling can increase product differentiation which may soften price competition
- **Entry deterrence**
  - Tying a competitively supplied product to a complementary monopoly product can exclude single product suppliers
  - More generally, bundling of complements can lower potential demand for a single product entrant
  - Tying can be used to commit to a more aggressive pricing strategy (competing for two margins, not one) which may deter entry and allow prices to rise long term

# Anti-competitive effects (ii)

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- **Stop current complements becoming substitutes in the future**
  - Bundle to avoid development of the complement
    - Microsoft – bundled internet explorer to stop threat of Netscape Navigator
- **Extend monopoly**
  - Markets tip to a single standard, bundling can extend a monopoly
    - Microsoft in the EU - WMP



*This document provides a general summary only and is not intended to be comprehensive. Specific legal advice should always be sought in relation to the particular facts of a given situation.*

