

Hearing Decision against Microsoft Corporation
 (Trading on Restrictive Terms Relating to Windows OEM Sales Agreements)
 <Tentative Translation>

September 18, 2008
 Japan Fair Trade Commission

The Japan Fair Trade Commission (“JFTC”) decided on September 1, 2004 to commence hearing procedures against Microsoft Corporation, (hereinafter referred to as “the Respondent”) and subsequently instructed the hearing examiners to go through the hearing procedures. On September 16, 2008, the JFTC issued a hearing decision (Judgment No. 13 of 2004), finding against the Respondent in accordance with the provisions of Paragraph 1 of Article 54 of the Antimonopoly Act as they stood prior to the amendments made pursuant to Law No. 35 of 2005.

1. Outline of the Respondent

Entrepreneur	Address	Representative
Microsoft Corporation	One Microsoft Way, Redmond, Washington State, USA	Steve Ballmer

2. Progress

July 13, 2004	Recommendation (Recommendation No. 22 of 2004)
September 1	Decision to commence hearing procedures
October 25	First hearing
August 6, 2007	17 th hearing (hearing procedures completed)
July 31, 2008	Draft decision sent to the Respondent
August 14	Opposition to the draft decision
September 16	Hearing decision

3. Summary of Decision

(1) Outline of the violation

From January 1, 2001 to July 31, 2004, the Respondent, when directly negotiating with entrepreneurs engaged in the manufacture and sale of personal computers (hereinafter referred to as “PCs”) in Japan, and executing licensing agreements for OEM sales of the PC operating system named “Windows” and owned by the Respondent (hereinafter referred to as the “OEM sales agreements”)^(Note 1), forced licensed PC manufacturers and sellers (hereinafter referred to as “OEMs”) to execute agreements containing a clause according to which they agreed not to initiate any lawsuit against the Respondent or any other licensee arising out of any infringement of the patent rights for the relevant PC operating system (hereinafter referred to as “Non-Assertion Provision”). The Respondent, by engaging in the practices mentioned above, did business with OEMs on terms that unjustly restricted their business activities (hereinafter, a PC operating system is referred to as a “PC OS,” the Windows PC OS is generally referred to as the “Respondent’s product” or the “Windows series,” and an OEM sales agreement containing a

Non-Assertion Provision that is executed through direct negotiations between the Respondent and an OEM is referred to as a “direct agreement”).

Furthermore, while the Respondent deleted the Non-Assertion Provision from its direct agreements on or after August 1, 2004, Non-Assertion Provisions in direct agreements terminating on or before July 31, 2004 continued to have effect even on and after August 2004^(Note 2).

These actions may adversely affect the fair competitive environment in the PC AV technology market^(Note 3) and they tend to impede fair competition, fall within section 13 (trading on restrictive terms) of the “Designation of Unfair Trade Practices” (JFTC Public Notice No. 15 of 1982), and are in violation of the provisions of Article 19 of the Antimonopoly Act.

(Note 1) While one party to an OEM sales agreement was the Respondent's subsidiary or a related entity, the Respondent itself participated in negotiations with OEMs, specified the license conditions and determined the wording of OEM sales agreements.

(Note 2) The widespread use of the Non-Assertion Provision affects not only the Respondent's licensed products, but also the Respondent's future products, replacement products and successor products, together referred to as the “future effect of the Non-Assertion Provision.”

(Note 3) Technology required to deliver functions enabling the user to see and hear digitized sounds or images on a PC.

(2) Outline of the principal text

A. The Respondent, when arranging for its subsidiaries or related entities to execute agreements with OEMs in Japan granting licenses for the use (including sales) of the Respondent's products, forced such OEMs to execute agreements containing the Non-Assertion Provision and thereby traded with such OEMs on terms that unjustly restricted the business activities of the licensees. The Respondent shall confirm that it ceased the above mentioned practices on August 1, 2004 at its business executive level.

B. The Respondent shall decide at its business executive level that the Non-Assertion Provision will not apply to any of its products shipped in future as far as any patent right related to the AV function is concerned, and shall send a written notice to that effect to the applicable OEMs. The method of this notice should be approved in advance by the JFTC.

C. The Respondent shall not take any action similar to A. above against any PC manufacturer or seller in Japan.

(3) Major issues

A. Whether OEMs were forced to execute direct agreements containing the Non-Assertion Provision;

B. Whether it was highly likely that the incentives of OEMs for PC AV technology research and development was undermined on or before July 31, 2004;

C. Whether it is highly likely that the incentives of OEMs for PC AV technology research and development continued to be undermined on and after August 1, 2004;

D. Whether the Non-Assertion Provision adversely affects competition in the market for PC AV technology and the PC market;

E. Whether there were any justification for the Non-Assertion Provision;

F. The appropriateness of the remedies.

(4) Outline of the Rulings made on the Issues

A. Whether OEMs were forced to execute direct agreements containing

the Non-Assertion Provision

In the year 2000, the Windows series represented 90% of all PC OSs worldwide and this percentage was increasing year after year. Obtaining a license for OEM sales of the latest version of the Windows series was indispensable for OEMs in order to continue in the business of manufacturing and selling PCs.

Furthermore, although the Respondent allowed the use of an indirect agreement^(Note) as an alternative to the direct agreement containing the Non-Assertion Provision, it is considered that OEM sales made under an indirect agreement would significantly weaken the competitiveness of the OEM in manufacturing and selling PCs, and would make it difficult to continue in the business of manufacturing and selling PCs through OEM sales.

In addition, no circumstances have been found suggesting that the Non-Assertion Provision could be deleted.

Therefore, it is recognized that OEMs were forced to execute direct agreements containing the unreasonable Non-Assertion Provision.

(Note) A type of agreement in which a license is obtained to make OEM sales of the Windows series by purchasing recorded media containing the Windows series via a sales agent of the Respondent.

B. Whether it was highly likely that the incentives of OEMs for PC AV technology research and development was undermined on or before July 31, 2004

In addition to the nature of having OEMs grant a royalty-free license, the Non-Assertion Provision may have been applicable not only to licensed products, but also to products sold in future for quite a long period of time and that, in line with the expansion of the functions of the Windows series, it would cover a wide range of patent rights subject to the free-of-charge license. Furthermore, (1) once a certain piece of technology related to the patent rights of an OEM was adopted in the Windows series, almost all PC users would be able to use the patent rights of the OEM concerned and it would become difficult for the OEM to recoup the investment in its technological development activities by licensing its PC AV technology to a third party or opting to use the PC AV technology it developed only in its own products without granting a license to any third party and differentiating its products; (2) technological information about the Windows series was not sufficiently disclosed and the OEM could not make a claim against the Respondent for any infringement of patent rights in agreement negotiations; (3) the Respondent expanded and enhanced the AV functions of the Windows series; and (4) several OEMs expressed their concern about the effect of the Non-Assertion Provision on patent rights for their PC AV technologies and requested that the Respondent delete the provision. For these reasons, it is recognized that OEMs were in a situation in which they had to develop PC AV technologies while recognizing the possibility that such technologies could be included in the Windows series.

Taking these circumstances into account, there was a high likelihood that the Non-Assertion Provision undermined the incentives of OEMs for PC AV technology research and development.

C. Whether it is highly likely that the incentives of OEMs for PC AV technology research and development continued to be undermined on or

after August 1, 2004

Due to the existence of the Non-Assertion Provision until July 31, 2004, there was a high likelihood that the incentives of OEMs for PC AV technology research and development was undermined for a long period of time, from January 1, 2001 until July 31, 2004. There was a concern that, as a result of this situation, the introduction of new technology or improved technology related to PC AV technologies and of products related to such technologies might be undermined. In addition, considering that even on or after August 1, 2004 the Non-Assertion Provision has continued to have effect on Windows series products licensed on or after August 1, 2004 in respect of the functions and characteristics inherited from products licensed on or before July 31, 2004, the deletion of the Non-Assertion Provision from the direct agreement did not immediately eliminate the likelihood that the incentives of OEMs for PC AV technology research and development was undermined or did not facilitate research and development activities related to PC AV technologies.

Furthermore, OEMs took the view that their patent rights for core PC AV technologies may have been infringed by Windows series products shipped on or before July 31, 2004, and there were reasonable grounds for this view.

Therefore, even after the deletion of the Non-Assertion Provision from direct agreements on or after August 1, 2004, it is appropriate to recognize that a high likelihood has been continuing that the incentives of OEMs for PC AV technology research and development activities were undermined.

D. Whether the Non-Assertion Provision adversely affects competition in the market for PC AV technology and the PC market

The OEMs and the Respondent are competitors in the PC AV technology trading market. Even if an OEM has influential PC AV technology, its incentives to research and develop such PC AV technology is undermined by the Non-Assertion Provision, and its position is weakened as a result. On the other hand, the Respondent distributes and disseminates its PC AV technology quickly and widely all over the world by installing it in Windows series products, and thus can strengthen its position. Taking these circumstances into account, there was a concern that the Non-Assertion Provision prevented and excluded competition in the market for PC AV technology and adversely affected the competitive market environment. Furthermore, taking into account the position of the Respondent in the PC AV technology market on or before July 31, 2004, it is recognized that this concern has remained from August 1, 2004, when the Non-Assertion Provision was deleted, until today.

In order to judge whether or not the fair competitive environment in the PC market was adversely affected, at a minimum, it is necessary to analyze how much the PC market was influenced by difficulties in differentiating products based on PC AV technology products including the role of AV functions in PCs. However, there is not enough evidence in this case record to judge whether the fair competitive environment in the PC market was adversely affected.

E. Whether there were any justification for the Non-Assertion Provision

The Respondent claims that the Windows series is a platform that is widely used in society, that there is a strong public interest in ensuring the stability of the rights and obligations associated with this platform, and that the Non-Assertion Provision, which provides this stability, is therefore procompetitive.

However, the Respondent, taking advantage of its strong position in the PC OS market, forced OEMs, which are its competitors in the PC AV technology field, to accept the Non-Assertion Provision and deny themselves the right to initiate a lawsuit relating to any infringement of patent rights. Even if the Non-Assertion Provision, which is an unjust device, has the effect of stabilizing the Windows series as claimed by the Respondent, it is not considered that it is sufficient to reverse the finding made in D above.

F. The appropriateness of the remedies

The Respondent has refrained from executing direct agreements containing the Non-Assertion Provision since August 1, 2004. However, (1) the effect of the Non-Assertion Provision since then has been based on the direct agreements executed on or before July 31, 2004; (2) at the time of completion of the procedure relating to the draft decision, the Windows series products on which the Non-Assertion Provision may continue to have an effect are limited to those succeeding the inventions forming part of or the functions and characteristics of the Windows series for which OEM sales have been licensed in the past; and (3) Article 19 of the Antimonopoly Act deems any action that "has tendency to impede fair competition" to be a violation of the Act in order to regulate unfair trade practices at an early stage before any problem actually arises and thereby prevent the possible development of substantial competitive restrictions. Taking these points into account, the order described in the principle text is appropriate to remove effect of the Non-Assertion Provision from Windows series products shipped in future and to prevent any recurrence of the violation.