

The JFTC renders a Recommendation to Microsoft Corporation

July 13, 2004
Fair Trade Commission

The Japan Fair Trade Commission (hereinafter “JFTC”), upon conducting an investigation into Microsoft Corporation (hereinafter “Microsoft”), found that Microsoft is conducting “Dealing on Restrictive Terms” and issued a recommendation to Microsoft on its violation of Section 19 of the Antimonopoly Act.

<Contact to the JFTC> First Special Investigation Division Special Investigation Department Tel: 81-3-3581-3382
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1 Company Concerned

Name	Microsoft Corporation
Address	One Microsoft Way, Redmond, Washington, USA
CEO	Steve Ballmer
Primary Businesses	Software Development and Licensing, Xbox etc

2 Outlines of Violations

Microsoft, when licensing Windows OS to personal computer manufacturers (hereinafter “PC manufacturers”), has concluded agreements with PC manufacturers containing certain provisions that a licensee covenants not to sue, bring, prosecute, assist or participate in any judicial, administrative or other proceedings of any kind against Microsoft, its subsidiaries, or other licensees for infringement of the licensee’s patents. Such conduct by Microsoft shall be construed as dealing with PC manufacturers on conditions which unjustly restrict their business activities, which the JFTC concluded correspond to the Subsection 13 of the Unfair Trade Practices, violating the section 19 of the Antimonopoly Act.

3 Summary of Measures to be recommended

Microsoft will terminate the certain provisions mentioned above (2) in the current and previous agreements concluded with Japanese PC manufactures.

4 Due Date of Acceptance or Rejection of this Recommendation

July 26, 2004

* If the recommendation is accepted, the JFTC will issue a decision, a legally binding order with the same elimination measures as those in this recommendation. Otherwise, the JFTC will initiate a hearing procedure.

Summary of Recommendation¹

1. Facts Recognized by the JFTC

- (1) Microsoft mainly has drafted the license agreement of Windows OS for PC manufactures, and has licensed Windows OS, through Microsoft Licensing Inc. before September 2003, and through Microsoft Licensing General Partnership in or after September 2003.
- (2) Microsoft has licensed Windows OS expressed in an object code style, not in a source code style.
- (3) Windows OS has been licensed to PC manufacturers through 2 (two) different channels:
 - (a) by directly negotiating terms and conditions with Microsoft (hereinafter “Direct Channel”),
 - (b) by purchasing the compact discs, which contain Windows OS, from the distributors of Microsoft (hereinafter “Distributor Channel”).
- (4) In the case that Microsoft licenses Windows OS by Direct Channel, Microsoft has limited the duration of the license to certain periods, such as 1 (one) year on or after July 2002.
- (5) Many PC manufacturers in Japan prefer Direct Channel rather than Distributor Channel because Distributor Channel entails the rise in procuring costs and end-users who purchased PCs suffer inconveniency in handling PCs. (Hereinafter “OEMs” refers to PC manufacturers who are granted the license of Windows OS by Direct Channel.)
- (6) The OEMs have manufactured the vast majority of PCs in which Windows OS was installed.
- (7) Since Microsoft started to license Windows 95 in 1995, the market share of Windows OS has dramatically increased. In 2003, this market share reached around 95 percent. Microsoft acquires the dominant position in both world-wide market and Japanese market of PC operating system.
- (8) In 1998, Microsoft started to license Windows 98 which contained Windows Media Player, that had the sophisticated audio and visual function applicable to digitized forms of music and pictures (hereinafter “AV Function”). Since then, Microsoft has been expanding and strengthening the AV Function of Windows OS.
- (9) Some OEMs have been active in developing technologies of AV Function.

¹ This summary is provisional translation prepared only for reference purpose. The authentic copy is prepared only in Japanese text, which is available at the JFTC web page: <http://www2.jftc.go.jp/e-page/index.htm>.

- (10) Because of the dominant position which Microsoft enjoys and end-users' strong preference to purchase PCs with the operating software which contains new functions, it is important business strategy for PC manufacturers to get the license of every new version of Windows OS and to ship PCs with such Windows OS at the same time when Microsoft starts to license such Windows OS.
- (11) Microsoft, since around 1993, has licensed Windows OS by entering license agreements with OEMs which contains licensee's covenants not to sue against Microsoft, subsidiaries of Microsoft, or other licensees for infringement of such licensee's patents on account of Windows OS licensed to such licensee.
- (12) In December of 2000, Microsoft presented OEMs the draft of the license agreement containing the following elements (hereinafter "Non-Assertion Provision") and stipulating that Non-Assertion Provision would survive termination or expiration of the license agreement (hereinafter "Survival Provision"):
- (a) Licensee agrees not to (A) sue, or (B) bring, prosecute, assist or participate in any judicial, administrative or other proceedings of any kind against Microsoft, its subsidiaries, or other licensees for infringement of the licensees patents which occurs during the Immunity Period on account of the manufacture, use, sale, or distribution of any products licensed, or, future replacement or successor products to the products presently licensed, to the extent such future replacement or successor products embody inventions embodied in the products presently licensed,
 - (b) The licensees' patents to which the above (a) applies mean all patents owned presently by the licensees, or acquired by the licensees prior to the termination or expiration of the license agreements, and
 - (c) The "Immunity Period" shall terminate upon the last to expire, of any of the licensees' patents.
- (13) Part of OEMs, which owned patents in the area of technologies related to AV Function, asserted that Non-Assertion Provision and Survival Provision would impose tremendous impact on their business. However, Microsoft did not respond to their assertions. The OEMs had no choice but to enter the license agreement drafted by Microsoft "as is".
- (14) Then, Microsoft made its policy that it should use the common form of the license agreement when it licensed Windows OS to any and all OEMs in or after February 2002. In December 2001, Microsoft presented OEMs its draft of the license agreement that became effective from February 2002 to July 2002.
- (15) This license agreement contained Non-Assertion Provision and Survival Provision. At this time, Non-Assertion Provision incorporated the following elements:

- (a) Licensee covenants not to (A) sue, or (B) bring, prosecute, assist or participate in any judicial, administrative or other proceedings of any kind against Microsoft, its subsidiaries, or other licensees for infringement of the licensees patents on account of the making, use, offer for sale, importation or other disposition or promotion of the products presently licensed,
 - (b) To the extent that the features and functionality presently contained in the licensed products are also contained in future replacement or successor products to the licensed products, such specific features and functionality in such future replacement or successor products shall also be considered part of the licensed products,
 - (c) The licensees' patents to which the above (a) applies mean all patents owned presently by the licensees, or acquired by the licensees prior to the termination or expiration of the license agreements, and
 - (d) The covenants of (a) shall terminate as to all infringements occurring more than three (3) years after the licensee stops distributing the licensed products.
- (16) Part of OEMs, which owned patents in the area of technologies of AV Function, strongly requested Microsoft to delete or modify Non-Assertion Provision and Survival Provision. The reasons were as follows.
- (a) It was likely that Windows OS infringed their patents.
 - (b) Moreover, even though any technologies, which had been developed and were to be developed by OEMs, were incorporated into the coming Windows OS because of the continuous expansion of the function of Windows OS, Non-Assertion Provision and Survival Provision would restrain such OEMs from asserting the infringement of their technologies against Microsoft and/or its licensees. There was good possibility that OEMs could not recoup their expenditures to develop their technologies in this situation.
- (17) However, Microsoft rejected such requests from OEMs, and most of OEMs had no choice but to conclude the license agreement "as is".
- (18) Thereafter, Microsoft presented OEMs its draft of the license agreement that became effective from August 2002 to July 2003, and from August 2003 to July 2004. Such draft contained Non-Assertion Provision and Survival Provision. Part of OEMs, which owned patents in the area of technologies related to AV Function, strongly requested Microsoft to delete or modify Non-Assertion Provision and Survival Provision for the same reasons mentioned in the above Section (16). As Microsoft rejected such request, all the OEMs had no choice but to conclude the license agreement "as is".
- (19) From the facts mentioned from the above Section (11) to (18), OEMs are precluded from suing against Microsoft or most of other PC manufacturers for infringement of such OEMs' patents. Especially, OEMs, which own patents in the area of technologies of AV Function, even though such OEMs' patents are likely to be infringed by Windows OS, are

restrained from enforcing such patents against Microsoft and/or most of other PC manufacturers. This situation may cause these OEMs to lose their incentives to invent and develop the technology related to AV Function, resulting in tending to impede the fair competition in the area of the technology related to AV Function in Japan.

- (20) Around February 20, 2004, Microsoft announced that it had determined to exclude Non-Assertion Provision from its next draft of the license agreements that became effective from August 1, 2004 to July 31, 2005. However, according to Survival Provision in the license agreements that became effective on or before July 31, 2004, Non-Assertion Provision in such license agreements still remains effective even after August 1, 2004.

2. Application of Law

According to the above mentioned facts, when Microsoft licenses Windows OS to PC manufactures, it restrains PC manufactures from suing against Microsoft, its subsidiaries, or other licensees for the infringement of their patents. Such conducts by Microsoft shall be construed as dealing with PC manufacturers under the conditions that unjustly restrict their business activities. The JFTC concludes that such conduct falls under the category that stipulated in the Subsection 13 of the Unfair Trade Practices, violating the section 19 of the Antimonopoly Act.

3. Elimination Measures that the JFTC Recommends

- (1) Microsoft shall terminate the following elements in the license agreements concluded with Japanese PC manufactures and became effective from August 1, 2003 to July 31, 2004:
- (a) Licensee covenants not to (A) sue, or (B) bring, prosecute, assist or participate in any judicial, administrative or other proceedings of any kind against Microsoft, its subsidiaries, or other licensees for infringement of the licensees patents on account of the making, use, offer for sale, importation or other disposition or promotion of the products presently licensed,
 - (b) To the extent that the features and functionality presently contained in the licensed products are also contained in future replacement or successor products to the licensed products, such specific features and functionality in such future replacement or successor products shall also be considered part of the licensed products,
 - (c) The licensees' patents to which the above (a) applies mean all patents owned presently by the licensees, or acquired by the licensees prior to the termination or expiration of the license agreements, and
 - (d) The covenants of (a) shall terminate as to all infringements occurring more than three (3) years after the licensee stops distributing the licensed products.
- (2) Microsoft shall terminate the following elements in the license agreements concluded with Japanese PC manufactures on or before July 31, 2003:

- (a) Similar terms as above mentioned (1) (a) to (d),
 - (b) Licensee agrees not to (A) sue, or (B) bring, prosecute, assist or participate in any judicial, administrative or other proceedings of any kind against Microsoft, its subsidiaries, or other licensees for infringement of the licensees patents which occurs during the Immunity Period on account of the manufacture, use, sale, or distribution of any products licensed, or, future replacement or successor products to the products presently licensed, to the extent such future replacement or successor products embody inventions embodied in the products presently licensed, and
 - (c) The “Immunity Period” shall terminate upon the last to expire, of any of the licensees’ patents.
- (3) Microsoft shall inform the Japanese OEMs of the following items (a) to (c) in writing. The method to inform shall be approved by the JFTC in advance:
- (a) Microsoft terminated the licensing elements stated in the above (1) (a) to (d),
 - (b) Microsoft terminated the licensing elements stated in the above (2) (a) to (c), and
 - (c) From now on, licensees of Windows OS are not be precluded from suing, bringing, prosecuting, assisting or participating in any judicial, administrative or any other kinds of proceedings against Microsoft, its subsidiaries, or other licensees for infringement of the licensees’ patents on account of the making, use, offer for sale, importation or other disposition or promotion of the products presently licensed.
- (4) From now on, whenever Microsoft licenses Windows OS to Japanese PC manufactures, it shall not preclude them, by conclusion of any agreements or any other means, from suing, bringing, prosecuting, assisting or participating in any judicial, administrative or any other kinds of proceedings against Microsoft, its subsidiaries, or other licensees for infringement of the licensees’ patents on account of the making, use, offer for sale, importation or other disposition or promotion of the products presently licensed.
- (5) Microsoft shall promptly report these measures that it adopts under the above four (4) items, to the JFTC.