II

(Acts whose publication is not obligatory)

COMMISSION

COMMISSION DECISION

of 20 December 1977

relating to a proceeding under Article 85 of the EEC Treaty

(IV/29.151 — video cassette recorders)

(Only the Dutch and German texts are authentic)

(78/156/EEC)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Economic Community, and in particular Article 85 thereof,

Having regard to Council Regulation No 17 of 6 February 1962 [1], and in particular Articles 3 and 4 thereof,

Having regard to the notification made pursuant to Article 4 of Regulation No 17 on 8 December 1975 by Philips GmbH, Hamburg and five other German undertakings concerning agreements on uniform application of technical standards for the VCR system,

Having regard to the Commission Decision of 3 June 1977 to initiate a proceeding,

Having heard the undertakings and associations of undertakings concerned in accordance with Article 19 (1) of Regulation No 17 and with Regulation No 99/63/EEC of 25 July 1963 [2],

Having regard to the opinion delivered on 8 November 1977 pursuant to Article 10 of Regulation No 17 by the Advisory Committee on Restrictive Practices and Dominant Positions,

Whereas :

(1) OJ No 13, 21. 2. 1962, p. 204/62.
(2) OJ No 127, 20. 8. 1963, p. 2268/63.

I

The facts

1. *The undertakings involved — market structure*

1 The following undertakings were party to the agreements notified :

(a) in the Netherlands :

— NV Philips' Gloeilampenfabrieken, Eindhoven ;

(b) in Germany :

(i) Blaupunktwerke GmbH, Hildesheim ;
(ii) Bosch-Siemens Hausgeräte GmbH, Munich ;
(iii) Grundig AG, Fürth, Bavaria ;
(iv) Loewe Opta GmbH, Kronach ;
(v) Norddeutsche Mende Rundfunk KG, Bremen ;
(vi) Philips GmbH, Hamburg ;
(vii) Schwarzwälder Apparate-Bau-Anstalt SABA-Werke, Villingen.

The agreements were notified on behalf of undertakings (b) (i) and (b) (iii) to (vii).

2 All these undertakings are active in the consumer electronics industry and are interested in the developing market for video cassettes and video cassette recorders.

3 These are designed to record and replay visual material on a magnetic tape housed in a cassette ; they can be used to record both black-and-white and colour television programmes, provided that these are transmitted by the PAL or SECAM systems.

4 As well as the parties here concerned there are other manufacturers in the consumer electronics field who are interested in this market, above all the Sony group. On the European market the following undertakings or groups of undertakings should be mentioned : AEG-Telefunken, Hitachi, Matsushita, Thorn, Toshiba, Sanyo and Zanussi.

5 So far only Philips and Sony have developed marketable video cassette systems for sale in Europe, the VCR system and the U-MATIC system respectively. The Sanyo Electric Co. of Japan has also recently tried to gain a foothold in the European market with a system that meets European television standards. In addition AEG Telefunken is preparing to introduce the TED videodisc system, which enables video material to be replayed on the television screen in the same way as a videotape system (but which, unlike the cassette system, does not allow the individual to record his own programmes). Philips, too, is developing a videodisc system, known as the VLP system.

6 Philips has a pre-eminent position in the European market for video cassette recorders. Its market share is considerably larger than that of Sony, its nearest competitor. The two together account for more than 70 % of total sales in the common market. Since this is a relatively new product, there are no official production and sales statistics available for the European Communities. Estimated sales of video cassette recorders in the EEC totalled 34 500 in 1974, 41 000 in 1975, and the upward trend continued in 1976.

7 Both Philips and Sony license a number of other firms to exploit their patents in the field of magnetic video recording and replay. The two companies' systems are technically different, which means that the cassettes can only be played on compatible equipment.

2. *The notified agreements*

8 The agreements at issue, which were operated with effect from 16 May 1975 and have since been discontinued (see paragraph 20 below), consisted of a basic 'agreement on uniform application of technical standards for the VCR system' together with a 'supplementary letter'.

9 The preamble to the basic agreement first states that Philips markets video cassette recorders and video cassettes using the VCR system, which it developed. It points out that the other parties to the agreement also have an interest in marketing the equipment and have decided to use Philips' VCR system. It also provides, unlike the usual type of agreements on standards, for the adoption of the complete system of one of the parties (Philips) by the other parties.

10 The preamble also claims that it is in the interest of the parties that the consumer should be able to use and play back the VCR video cassette on the equipment of as many manufacturers as possible without loss of quality. For this reason, as is set out below, the parties agreed to uniform application of the same technical standards, which are needed to ensure compatibility.

11 The most important provisions of the basic agreement are found in paragraph 2, which provides for the exclusive use of VCR standards.

The parties undertake to observe the technical standards laid down in Annex I to the agreement for the manufacture and/or distribution of video cassette recorders and video cassettes (see paragraph 2, read in conjunction with paragraph 1 (a) and (b) of the basic agreement). In 16 pages with 10 illustrations Annex I contains a description of the technical manufacturing standards for VCR magnetic videotape cassettes and videotape recorders. No change to these technical standards may be made without the consent of all the parties (paragraph 3).

12 The parties grant each other royalty-free, non-exclusive and non-transferable licences under their patents and patent applications affecting compatibility, where this is needed to ensure compatibility (paragraph 4).

13 Other manufacturers of VCR machines and companies associated with the original parties — including those outside Germany — are free to become parties to the agreement (paragraph 5). The parties accept that their obligations are not to be circumvented by the intervention of companies associated with them (paragraph 7).

14 The agreement entered into force upon notification to the Bundeskartellamt, Berlin, on 16 May 1975 and was to have effect in the first instance until 31 December 1975. Thereafter the agreement was to be extended by two-year periods unless any of the parties terminated it, giving not less than six months' notice before expiry. In the event of termination by one party the agreement would continue between the remaining parties. Within three months of such termination any other party could give notice that it wished to withdraw (paragraph 9 (1)).

15 Any party terminating the agreement forfeited licences under the patents of the other parties granted pursuant to paragraph 4. For the duration of the licences, the remaining parties retained their licences pursuant to paragraph 4 under the patents and patent applications of the terminating party, provided the first application (establishing priority) was filed before termination (paragraph 9 (3)).

16 In the 'supplementary letter to the agreement on uniform application of technical standards for the VCR system', which was signed at the same time as the agreement itself, the parties agreed to ensure that their associated companies outside Germany would likewise observe the obligations contained in paragraph 2 (observance of VCR standards) and paragraph 3 (allowing only agreed changes in the standards) when manufacturing and distributing video cassette recorders and video cassettes outside Germany (paragraph 1).

17 Any associated company outside Germany which observed the abovementioned obligations also benefited from the licences granted pursuant to paragraph 4, provided it granted equivalent licences under its own patents to the parties and their associated companies (paragraph 2).

3. *Other findings of fact; the undertakings' arguments*

18 (a) Philips has from time to time licensed other European and non-European undertakings to use its industrial property rights in VCR video cassettes and video cassette recorders. These licensing agreements were not notified to the Commission, and they are not at issue in this proceeding. None of these agreements contains an obligation on the part of the licensee to use only the VCR system when manufacturing video cassettes and video cassette recorders.

19 (b) Philips asserts that the obligation on the contracting parties contained in paragraph 2 of the basic agreement to manufacture and distribute only VCR cassettes and recorders can be justified as the *quid pro quo* for the royalty-free licences. The only way the VCR system could be assured of a firm foothold on the market was to make it impossible for licensees to change over to another manufacturer's system while the agreement was in force.

The same justification is advanced for the termination clause (paragraph 9 (3) of the basic agreement), whereby the terminating party forfeited all its licences while the remaining parties retained their licences under the patents of the terminating party.

20 (c) At a meeting on 23 March 1976, representatives of NV Philips' Gloeilampenfabrieken, Eindhoven, and of Philips GmbH, Hamburg, were informed by the Commission's representative that there were serious legal objections to the restrictive practices contained in the agreements. This was confirmed by letter dated 13 May 1976 from the competent Director in the Directorate-General for Competition to NV Philips' Gloeilampenfabrieken. After receiving the Commission's statement of objections dated 16 June 1977, the under-

takings concerned negotiated the immediate cancellation of the notified agreements. They informed the Commission by letter of 5 September 1977 that the agreements had been terminated with immediate effect, but that they did not thereby admit the factual and legal arguments advanced by the Commission. The parties requested a termination of the proceedings, arguing that they had become groundless and refused the invitation to a hearing. The parties had, however, been warned that they were still to expect a Commission decision establishing infringements of Article 85 (1), even if only in respect of infringements which had now ceased.

II

Applicability of Article 85 (1)

21 It is accepted that the agreements notified to the Commission were cancelled with immediate effect, as stated by the parties in their letter dated 5 September 1977. However, in view in particular of the legal arguments advanced by the parties, there is still a clear interest in establishing whether the restrictive practices in issue did in fact fall within Article 85 (1).

22 Article 85 (1) prohibits as incompatible with the common market all agreements between undertakings which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the common market, in particular those which, in the words of Article 85 (1) (b), limit or control production, markets, technical development, or investment.

23 The 'agreement on uniform application of technical standards for the VCR system' (basic agreement), together with the 'supplementary letter', constituted agreements between undertakings for the purpose of Article 85 (1).

The agreements contained clauses which had as their object the restriction of competition within the common market, and that in a rather unusual but relatively restrictive form.

1. Paragraph 2 of the basic agreement required the parties to observe the technical standards laid down in Annex I for the manufacture and distribution of video cassette recorders and video cassettes. As these standards were for the manufacture of VCR equipment, the parties were obliged to manufacture and distribute only cassettes and recorders conforming to the VCR system licensed by Philips. They were prohibited from changing to manufacturing and distributing other video cassette systems, Sony's U-MATIC for example, as long as these obligations continued. They were not even allowed to use other systems at the same time. This constituted a restriction of competition under Article 85 (1) (b), which was designed to limit the technical development, production and sale of other video cassette systems.

24 2. Of particular importance were the licensing provisions contained in the agreements, which in fact amounted to a horizontal complex of licensing agreements which should otherwise have been bilateral.

According to paragraph 9 (3) of the basic agreement a party terminating the agreement would forfeit immediately its licences (acquired by virtue of paragraph 4) under the patents of the other parties. On the other hand the remaining parties kept their licences under the patents of the terminating party. This constituted an additional restriction of competition, reinforcing the restriction arising from paragraph 2. In the first place, if a party was contemplating manufacturing another system after withdrawing from the agreement, its decision was rendered more difficult by the knowledge that it would no longer be able to use investments it had already made for the manufacture of the VCR system. Secondly, an undertaking contemplating such action must also have had to bear in mind that its own patents (e.g. patents for new applications and improvements), which might well be of use in the manufacture of another system, would still be exploited free of royalties by its former partners.

25 3. In view of the pre-eminent market position held by Philips, the leading licensor at the time, these restrictions of competition were particularly marked. The existing restriction on the freedom of action of Philips' partners

arising from the termination requirements would have been enough, given the relative strength of the companies, to dissuade them from any attempt to adopt another system.

26 The agreement was also likely to affect trade between Member States appreciably. All Philips' partners in the agreement are vigorous undertakings in the electronics industry with effective sales organizations in most Member States. The fact that their present market shares are low in comparison with that of Philips does not reduce the appreciable effect on trade. As this is a relatively new product, which has not by any means reached all potential customers, the firms' sales organization will be increasingly important in the further development of the market. It could justifiably be feared that the tying of these undertakings to the VCR systems would have substantial effects on inter-State trade.

III

Applicability of Article 85 (3)

27 The parties' request for termination of the proceedings also indicated that their request for an exemption under Article 85 (3) had thereby lapsed. In any event the conditions for an exemption under this provision were not satisfied.

28 1. Apart from its licensing provisions the 'agreement on the uniform application of technical standards for the VCR system' also contains provisions concerning the manufacture of products by means of the uniform application of a range of different technical standards necessary to manufacture a certain type of product.

29 The main provision concerning the uniform application of standards was to be found in paragraph 2 of the basic agreement (the observance of VCR standards). On the positive side, this requirement entirely achieved its main purpose : the use of VCR video-cassettes on the machines of other manufacturers. To this extent it may have been assumed that there were advances in manufacture which led to an improvement in the distribution to the benefit of the consumer in that suitable video cassettes were made more readily available. In fact no significant improvement in production or distribution was achieved since compliance with the VCR standards led to the exclusion of other, perhaps better, systems. Such an exclusion was particularly serious in view of the pre-eminent market position enjoyed by Philips.

30 Moreover consumers were not allowed a fair share of the resulting benefits. For the agreement denied them the opportunity to buy video cassettes or video cassette recorders of a different system from any of the parties. The parties were not even in a position to offer the consumer cassettes or machines of another system which had been manufactured by firms outside the agreement. For the mere distribution of products which did not meet VCR standards was also forbidden them under paragraph 2 of the basic agreement.

31 At the same time restrictions were imposed upon the parties which were not indispensable to the attainment of these improvements. The compatibility of VCR video cassettes with the machines made by other manufacturers would have been ensured even if the latter had to accept no more than an obligation to observe the VCR standards when manufacturing VCR equipment. As much is evident from the less restrictive obligation which is all that is required by the separate licensing agreements that Philips has entered into with other European and non-European manufacturers.

32 2. In view of the foregoing it is not necessary to evaluate the licensing provisions in the basic agreement by reference to Article 85 (3). These restrictions would also have disqualified the agreement from exemption under Article 85 (3). Admittedly the agreement may have contributed to technical progress — as may often be the case with licensing agreements. And the combined technical efforts of the parties could be expected to lead to further rationalization, particularly with regard to the exchange of licences for patents for improvements and new

applications of inventions pursuant to paragraph 4 of the basic agreement. But the effective restriction of the parties' freedom of action arising out of the licensing arrangements in the event of termination (paragraph 9 (3) of the basic agreement) was not indispensable to the attainment of these objectives, so that Article 85 (3) was not applicable even if the negative effects of the exclusion of other systems were to be disregarded (see paragraphs 29 and 30 above),

HAS ADOPTED THIS DECISION :

Article 1

The provisions of paragraph 2, read in conjunction with paragraph 1 (a) and (b), and of paragraph 9 (3), of the 'agreements on uniform application of technical standards for the VCR system', which were notified to the Commission on 8 December 1975, constituted during the time they were in force (16 May 1975 to 5 September 1977) infringements of Article 85 (1) of the Treaty establishing the European Economic Community.

Article 2

This Decision is addressed to :

1. Blaupunkt Werke GmbH, Hildesheim, Federal Republic of Germany ;
2. Bosch-Siemens Hausgeräte, GmbH, Munich, Federal Republic of Germany ;
3. Grundig AG, Fürth, Bavaria, Federal Republic of Germany ;
4. Loewe Opta GmbH, Kronach, Federal Republic of Germany ;
5. Norddeutsche Mende Rundfunk KG, Bremen, Federal Republic of Germany ;
6. Schwarzwälder Apparate-Bau-Anstalt SABA-Werke, Villingen-Schwenningen, Federal Republic of Germany ;
7. Philips GmbH, Hamburg, Federal Republic of Germany ;
8. NV Philips' Gloeilampenfabrieken, Eindhoven, Netherlands.

Done at Brussels, 20 December 1977.

For the Commission

Raymond VOUEL

Member of the Commission