

U.S. v. Microsoft: Remedies at the Expense of Consumers

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¹ Mr. Gray, former counsel to President George Bush and partner at Wilmer, Cutler & Pickering, represents the Association for Competitive Technology (“ACT”). ACT is a nonprofit association representing over 9,000 companies in the information technology (“IT”) industry. Its membership includes direct corporate and individual members, plus indirect corporate members through other industry associations that have joined ACT. Representative of the IT industry, ACT’s membership is made up mostly of small and medium sized businesses but includes household names such as CompUSA, Excite at Home, Intel, Microsoft and Symantec. ACT members come from all walks of the IT industry including software for Windows and other operating systems, hardware, reseller, consulting and on-line, unified by the cause of protecting competition and innovation in the IT industry. ACT’s interest in the Microsoft case stems from its knowledge that Microsoft, by providing the reliable, stable, widely used, and continually improving Windows operating system, has enabled thousands of competing companies to build today’s \$500 billion market for products and services for the Windows platform and has improved the products offered to consumers using other platforms as well.

As an initial matter, it is my opinion that the case against Microsoft is almost certain to be overturned on appeal.² Fundamentally, I think it is impossible to argue that a company that has denied a monopoly to a competitor and has injected competition where there was none is guilty of anything under the antitrust laws.³ I think it is impossible to argue that a company that has made an unprecedented investment in innovation to the benefit of consumers is guilty of anything under the antitrust laws.⁴ And I think it is impossible to argue that a company that has significantly increased access and use of the Internet is guilty of anything under the antitrust laws.⁵

Turning to Judge Jackson's conclusions of law, I am convinced that they will not stand up to appellate scrutiny. His finding on monopoly maintenance, for example, is premised on a new doctrine of predatory innovation that would prohibit a company with a dominant position in one market from providing too many benefits to consumers in another. Thus, the heart of the

² Our analysis of the law in this case is available in our amicus brief for the Association for Competitive Technology, which can be found either at www.wilmer.com or www.actonline.org.

³ See, e.g., *Intergraph Corp. v. Intel Corp.*, 195 F.3d 1346, 1360 (Fed. Cir. 1999) ("It is an enlargement of antitrust theory and policy to prohibit downstream integration by a "monopolist" into new markets. . . . As we have discussed, the purpose of the antitrust laws is to foster competition in the public interest, not to protect others from competition, in their private interest."); *Alaska Airlines, Inc. v. United Airlines, Inc.*, 948 F.2d 536, 548 (9th Cir. 1991) ("The anticompetitive dangers that implicate the Sherman Act are not present when a monopolist has a lawful monopoly in one market and uses its power to gain a competitive advantage in the second market."); *Berkey Photo, Inc. v. Eastman Kodak Co.*, 603 F.2d 263, 276 (2nd Cir.1979) ("So long as we allow a firm to compete in several fields, we must expect it to seek the competitive advantages of its broad-based activity – more efficient production, greater ability to develop complementary products, reduced transaction costs, and so forth. These are gains that accrue to any integrated firm, regardless of its market share, and they cannot by themselves be considered uses of monopoly power.").

⁴ See, e.g., Findings of Fact ¶ 61 ("[A]lthough Microsoft could significantly restrict its investment in innovation and still not face a viable alternative to Windows for several years, it can push the emergence of competition even farther into the future by continuing to innovate aggressively. While Microsoft may not be able to stave off all potential paradigm shifts through innovation, it can thwart some and delay others by improving its own products to the greater satisfaction of consumers.")

⁵ See, e.g., Findings of Fact ¶ 408 (Microsoft's actions "contributed to improving the quality of Web browsing software, lowering its cost, and increasing its availability, thereby benefiting consumers." Microsoft also "increased general familiarity with the Internet and reduced . . . cost to the public of gaining access.").

court's illegal monopoly maintenance charge is that Microsoft made "large investments in software development for [Internet Access Providers'] benefit, conceded opportunities to take a profit, suffered competitive disadvantage to Microsoft's own OLS, and gave outright bounties."⁶ These foregone profits include the court-acknowledged benefit to consumers of Microsoft's free browser product in competition with Netscape's fee-based product,⁷ and Microsoft's free Internet Access Provider package which was superior to a nearly \$2,000 Netscape product.⁸ It turns the antitrust laws on their head to suggest that, by charging nothing for these products and forcing Netscape to innovate and reduce fees, Microsoft has harmed competition, hurt consumers, and violated the law. The government's and the court's theory, not explicitly stated, must be that the benefit to Microsoft of expanding the number of Internet users and the subsequent increase in computer purchases by promoting the Web through Internet Explorer was less than the foregone profits that could have been made if it charged consumers as much as Netscape wanted to do in a world of slow-growing Internet use. That is patently wrong. Microsoft came to the aid of consumers by injecting competition where none had been, vastly expanding the Web in the process (and helping America Online more than quadruple its customer base). That cannot be a violation of the antitrust laws.

⁶ Judge Jackson's Conclusions of Law, at 16 (Apr. 3, 2000) (citing Findings of Fact ¶¶ 259-60, 277, 284-86, 295).

⁷ *See, e.g.*, Findings of Fact ¶ 136 ("In addition to improving the quality of Internet Explorer, Microsoft sought to increase the product's share of browser usage by giving it away for free. In many cases, Microsoft also gave other firms things of value (at substantial cost to Microsoft) in exchange for their commitment to distribute and promote Internet Explorer, sometimes explicitly at Navigator's expense.")

⁸ *See, e.g.*, Findings of Fact ¶ 250 ("Many IAPs would have paid for the right to distribute Internet Explorer. Indeed, Netscape was charging IAPs between fifteen and twenty dollars per copy of Navigator they distributed. Because of the features and convenience it offered, the IEAK significantly increased the price that IAPs would have been willing to pay. Nevertheless, Microsoft licensed the IEAK, including Internet Explorer, to IAPs at no charge. At the time Microsoft released the IEAK, Netscape did not offer IAPs an analogous tool. Although Netscape eventually followed Microsoft's lead by introducing a tool kit similar to the IEAK known as Mission Control, that kit was not made available to IAPs until June 1997 — a full nine months after the release of the IEAK. Whereas IAPs could obtain the IEAK for free, Netscape initially charged \$1,995 for each copy of Mission Control.")

The court's finding of attempted monopoly in the browser market is also flawed because, as a factual matter, America Online (the owner of Netscape) has always possessed the power to deny a browser monopoly to Microsoft. Developments since the Judge's findings of fact suggest this may actually happen soon. AOL's recent "AOL Anywhere" campaign is almost certain to adopt Netscape as its browser after the termination of its contract with Microsoft at the beginning of next year. This act will shift more than 20 million Internet Explorer users back to Netscape. Influence of this magnitude in the hands of arguably the most prominent player on the Internet certainly was and remains an absolute obstacle to monopoly in the browser market.

Finally, the court's tying finding, as a legal matter, has already been flatly rejected by the D.C. Circuit. Of course, these are merely the highlights of the appellate case that I think that Microsoft is certain to bring in the future, but it is important to remember the backdrop against which our discussion of remedies is being made.

Many people have viewed the recent decision by Judge Jackson as a victory for the government. But this case is really, at least for now, a victory for Microsoft's powerful competitors.² Companies such as Sun, Oracle, and Netscape have encouraged this litigation because it was an opportunity to harm Microsoft's ability to innovate and become competitive in new markets, such as Internet browser software, back office server products, and productivity applications. Microsoft has every right to enter and compete vigorously in these markets outside its area of monopoly. Because Microsoft has innovated into its competitors' areas of business, slashed its prices, and dramatically increased output, Microsoft's competitors recognize that any harm to Microsoft from the government's case is in their direct financial interest. With

² The entire purpose of antitrust law is protection of consumer welfare, not the protection -- or enhancement -- of competitors, that goal must also be paramount when crafting an antitrust remedy. *See* Robert H. Bork, *The Antitrust Paradox* 51, 56-89 (1978).

Microsoft hampered or eliminated from competing by remedies such as those proposed by the government, these competitors will once again be free to raise prices, reduce spending on innovation, and reduce responsiveness to customer concerns. That is what is at stake during this stage of the case.

The proposed remedies by the Government and States against Microsoft suffer from at least four major problems:

First, the case is already substantially moot.

Second, many of the remedies that have been proposed are unrelated to the conduct that the judge found illegal.

Third, by any reasonable analysis, the remedies that have been proposed are grossly disproportionate to the harm that the judge found.

Fourth and most importantly, the proposed regulatory scheme will harm consumers.

I. The case is substantially moot.

The complaint brought by the Department of Justice and the States had three basic allegations: (1) allegedly unlawful provisions in Microsoft's contracts with Internet Service Providers, Internet Content Providers, Online Services, and Independent Software Vendors regarding the development, promotion, and distribution of web browsing software; (2) allegedly unlawful provisions in Microsoft's license agreements with computer manufacturers prohibiting the removal of features or functionality from Windows 98; and (3) alleged tying of standalone web browsing software to Microsoft's Windows 98 operating system.

All the contractual provisions at issue in this case have already been terminated, have been significantly amended, or will expire in the very near future. Thus, it seems clear that, even accepting the court's conclusions and findings of fact, the only remedy necessary to address

them is an injunction that would punish any attempts to reestablish any similar improper contractual relationships.¹⁰ I will discuss these more below.

The Judge's conclusion on tying relied heavily on the fact that Microsoft's decision to componentize its browser was not derived from "technical necessity or business efficiency." It is very strange then that AOL's Netscape has just recently introduced a componentized browsing product known as Gecko that is supposedly the "next" generation of browsers. Well, once again, Microsoft's innovation got there first, and Netscape has been scrambling to catch up. Imitation is the sincerest form of flattery. But how can there be competitive harm resulting from componentization of the Internet Explorer browsing functionality when Netscape is now doing the same exact thing?

It is necessary here to address an obvious fact no one wants to discuss: the browser war is over, not because Microsoft won, but because it lost. It is over not because Microsoft offers an inferior browser. It doesn't. It is not over because the number of users who choose to use Internet Explorer is down. It isn't. It is over because AOL, as everyone knows, is going to switch back to the new and improved Netscape as soon as its current agreement with Microsoft is over at the end of this year. AOL is in a position to determine the outcome of the browser war (in part because of its skillful use of Explorer), and every Internet Content Provider and

¹⁰ Even the Judge's findings seem to acknowledge the limited impact of many of the challenged provisions. *See, e.g.*, Findings of Fact ¶ 267 (finding that the Windows 95 referral server agreements were "of relatively short duration"); *id.* ¶ 269 (finding that the Windows 98 referral server agreements had a one-year term and were terminable at will by the IAP on 90 days' notice); *id.* ¶ 331 (finding that the ICP agreements "expired within seven months of the Channel Bar's release"). Microsoft also unilaterally waived the challenged provisions of the IAP referral and ICP promotional agreements prior to the initiation of the lawsuit. (*Id.* ¶¶ 268-69, 331) With respect to the ICP agreements, the Findings state: "[T]here is not sufficient evidence to support a finding that Microsoft's promotional restrictions actually had a substantial, deleterious impact on Navigator's usage share." (*Id.* ¶ 332)

Independent Software Vendor who wants access to the more than 20 million AOL customers has known that this switch was likely to happen since AOL bought Netscape.

I would argue that the relevance of the government's case dies with the rebirth of Netscape. That certainly is the only conclusion I could draw after reading the government's proposed remedy. The government's complaint was about Internet Explorer. The remedies proposed are all about remaking the computer industry.

II. Many of the remedies that have been proposed are unrelated to the conduct that the judge found illegal.

Recognizing that Netscape Navigator and Sun's Java are still alive and well, it is not surprising that the government's proposed remedies are not focused on addressing any harm to the competitiveness of existing middleware products that might have jeopardized Microsoft's Windows monopoly. Instead, they are focused on Microsoft Office. But the Office application was not the focus of the government's case against Microsoft. Neither was Microsoft's server, Web TV, X-Box, Pocket PC, or E-book reader products. The case was about Internet Explorer. Why then is the government proposing to liberate these products from Microsoft? The government has chosen to dress up Office as a platform for APIs that it posits can challenge Window's monopoly at the same time the government has chosen to prevent Microsoft from innovating in and entering new product markets.

This approach is remarkable because there has not been any allegation or finding at any stage of the case that Microsoft's success in applications, other than its success in Internet browsers, involved questionable conduct. Put simply, the proposed structural remedies are far outside the scope of this case. They also stand in stark contrast with a complaint that did not

allege harm from Microsoft's non-Internet applications and did not suggest the need for structural remedies.

Many of the conduct remedies are similarly improper. For example, the government's proposals to regulate the price of Windows are overreaching. There was no evidence at trial that Microsoft priced Windows at monopoly prices (though it certainly would be permissible to do so).¹¹ And yet the government's proposal greatly restrains Microsoft's pricing behavior well beyond the finding that Microsoft improperly punished computer manufacturers who challenged aspects of its licensing agreements with Microsoft. Under the proposal, Microsoft is prohibited from offering any discounts on the price of Windows for undertaking pro-competitive activities such as maintaining good customer support services, fighting software piracy, or improving hardware offerings. The government also proposes to force pricing of different functionalities of Windows based on the number of bytes of software code used to implement the feature. Putting aside the fact that "payment by the byte" is unheard of in the industry and that smaller code is more desirable than larger code, I cannot imagine the amount of memory that will be required to run an operating system that is developed with incentives to be bulky. As with many of the remedies proposed, the government may have had some justification to ask for injunctive relief to prevent acts that the Court found to be anticompetitive (*for example*, pricing Windows differently for similarly situated OEMs), but they fail to show why these much broader remedies are justified or even necessary.

There is no evidence that the government has done anything to ensure the "punishment fits the crime," as the saying goes. In fact, the evidence is to the contrary. For example, though

¹¹ Findings of Fact ¶ 64.

the Court defined “middleware” as a program that exposes API’s to application developers while relying on the interfaces provided by the underlying operating system,¹² the government’s proposal has broadened it to “software that operates, directly or through other software, between an Operating System and another type of software (such as an application, a server Operating System, or a database management system) by offering services via APIs or Communications Interfaces to such other software, and could, if ported to or interoperable with multiple Operating Systems, enable software products written for that Middleware to be run on multiple Operating System Products.” If Microsoft Office fits the description, as the government suggests, it would seem there would only be a small percentage of software that does not meet the definition. The confusion doesn’t stop there. The proposed definition of “Middleware Product” includes any software distributed by Microsoft that has been distributed separately from the Operating System and provides functionality similar to that “provided by Middleware offered by a competitor to Microsoft.” So what is Middleware? Middleware is Middleware. It can mean nearly any software that communicates with any other software (except, of course, the two explicit non-Middleware applications of disk compression and memory management). Application of these confused definitions, which go to the heart of the proposed remedies, would cause Microsoft - whether in one or two pieces - to grind to a complete halt, exactly the result that Microsoft’s competitors have hoped for.

III. By any reasonable analysis, the remedies that have been proposed are grossly disproportionate to the harm that the judge found.

The Microsoft case is not like other Sherman Act cases that courts have ruled on in the past: American Tobacco, AT&T, or Standard Oil. Those cases involved the anticompetitive

¹² Findings of Fact ¶ 28.

accumulation of physical things. It is particularly interesting that the government would appeal so strongly to the AT&T case which Bill Baxter initiated, since that case was about breaking up a governmentally enforced monopoly. The Microsoft case is about breaking up a monopoly based on innovation, and is much more analogous to the IBM case, which Baxter dropped.

Unlike the precedent upon which the government relies, the Microsoft case is about human capital, not a collection of physical things. By telling the folks at Microsoft what types of future solutions they can or cannot think about, the government will stifle innovation and convert Microsoft into just another unimaginative software company. So let us reconsider the harm that Judge Jackson found in this case and see if it merits such harsh punishment.

Even Judge Jackson acknowledged that Microsoft generated enormous benefits for consumers - great innovation, lower prices, and increased output. As discussed earlier, his key finding is that Microsoft was too innovative, lowered prices too much, and increased output too significantly. This predatory conduct, the court said, was intended to protect Microsoft's existing monopoly. I believe that such protection was not necessary, and therefore I question whether there are grounds to impugn Microsoft's objectives in innovating for the benefit of its customers and the ultimate consumers. The "positive feedback loop" is alive and well. As the judge conceded, there was not sufficient evidence that Netscape and Java had any real potential as platforms to generate competition with Windows,¹³ just as there is no reason to believe that Office or Lotus Notes has such potential. It is remarkable then that the judge ruled that

¹³ Findings of Fact ¶ 411 ("There is insufficient evidence to find that, absent Microsoft's actions, Navigator and Java already would have ignited genuine competition in the market for Intel-compatible PC operating systems."); ¶ 407 ("It is not clear whether, absent Microsoft's interference, Sun's Java efforts would by now have facilitated porting between Windows and other platforms enough to weaken the applications barrier to entry."). Third-party accounts suggest that Netscape's and Java's potential as platforms for software development was exaggerated. See, e.g., Charles H. Ferguson, *High St@kes, No Prisoners*, 147-50, 288-89 (1999); Michael A. Cusimano & David B. Yoffie, *Competing on Internet Time* 174-180 (1998).

Microsoft's actions harmed the future choices of consumers. Such a finding, I think, is extremely speculative and cannot be used to justify the drastic and far-reaching remedies the government has proposed.

IV. The proposed regulatory scheme will harm consumers.

Particularly worrisome is the likely impact on consumers of the remedies proposed by the government. This is especially true because antitrust enforcement in this country is predicated on protecting consumers. Let's consider how some of the proposals will likely affect them.

As a first example, the proposal effectively prohibits Microsoft from ensuring that Original Equipment Manufacturers do not create what would amount to their own proprietary version of Windows.¹⁴ As a result, the stability of the Windows platform itself is likely to be undermined. No longer will consumers be assured that Windows applications will run on their OEM's version of Windows. Applications developers and peripheral hardware manufacturers would likely be forced to produce numerous versions of their products in order to serve the new balkanized landscape. Because some versions of Windows will lack functionality that some software will require, it is likely that software developers will have to expend the time and effort to build essential functionalities into their products. As a result, software innovation will almost certainly be harmed while prices increase.

A second example of clear consumer harm from the proposal is the fact that Microsoft is prevented from improving its Internet Explorer functionality, even though that code supports critical features in Windows. Any effort to speed the performance of the browser product on the desktop, support new features for web sites, implement new industry technical standards or even

¹⁴ See Government's Proposal, sections 3.a.iii and 3.f.

to fix bugs would be prohibited. As a result, Windows development will be set back many years and the incentive for new innovations will likely cease.

Perhaps the most troubling aspect of the proposal is that development of substantially all new products at Microsoft would be hampered. Microsoft's products draw on both operating system and applications technologies. By forcibly separating the intellectual capital relating to these areas pursuant to hopelessly circular definitions of "middleware" and "operating system," the government is delaying, if not destroying, the proliferation of next generation products such as speech, gesture, and handwriting recognition on the desktop; the X-Box game console; Pocket PC handheld products; "eBook" reader; and so many others. Consumers clearly will suffer.

But perhaps the most ominous potential harm to consumers would result from the splintering of the Microsoft company. No one seriously believes that the Windows monopoly is in danger of disappearing any time soon. Accordingly, once Microsoft's Operating System Business is stripped of all the incentives and ability to innovate into new product markets, its profitability will have to come exclusively from the price of Windows and there will be no disincentive to raise prices. In addition, the Microsoft Office company will be in a position to dominate the productivity applications industry and, without the steady stream of Windows license revenues, prices for the applications are bound to increase. By removing back office and server products from the Windows company, server system competitors will have every incentive to raise prices in celebration of the loss of the low-price, high-innovation competitor. Netscape will also be likely to charge for Navigator and its new Gecko functionality, without a vibrant Internet Explorer to keep it honest. And all of these probable price increases are justified by the possible future monopoly pricing of a monopoly product that costs less than five percent of the average desktop computer?

In sum, I believe that the only beneficiaries of the remedies proposed by the government would be Microsoft's competitors. Choosing winners and losers is not what antitrust enforcement is about. And antitrust enforcement is certainly not about remaking the computer industry according to government's vision of the way things should be.

The fact is that the future battle is not about operating systems software. It is about broadband and the Web, where no one firm, certainly not Microsoft, can dominate.¹⁵ We are enjoying the most vibrant economic boom in our country's history, thanks in part to Microsoft innovations. In such an environment, what needs to be fixed by the government?

¹⁵ See, e.g., *Microsoft Judge Faces Demands of Market And of Monopoly Law*, WALL STREET JOURNAL, Apr. 4, 2000, at A1 ("For all the harsh rhetoric of the current antitrust war, Microsoft has had a decidedly mixed record in using its dominance of personal computing as a springboard into new markets. On the Internet, in particular, Mr. Gates and his lieutenants face a medium that has expanded far beyond the point where any one company could still dictate terms. And even Microsoft critics acknowledge that the Internet is simply too big for any one company to dominate. International Data Corp., for instance, tracks 99 different software categories, and finds that Microsoft participates in only 21 of those - and has market share greater than 36% in only four."); Wylie Wong, *Ellison: The Net will break Microsoft*, available at <<<http://www.news.com/News/Item/0,4,31033,00.html>>> (quoting Larry Ellison, Oracle's CEO, as saying "the Internet is an 'organic revolution' in the industry that is moving businesses and consumers away from Microsoft Windows and client/server-based computer to network computing."); Peter H. Lewis, *Would A Breakup Matter?* NEW YORK TIMES, May 4, 2000, at E1 ("The operating system is just the dial tone that you need to make a call to the Internet. ... Windows is not a requirement to use the Internet. ... The Internet, not the desktop computer, is becoming the center of power.")