New York Law Journal

A Real Battle

With RealNetworks, the Microsoft Settlement Fails Its First Test

ANTITRUST ISSUES

JEFFREY I. SHINDER

When the Bush administration agreed to settle the Microsoft case, it claimed the settlement would protect competition from further abuses of the software giant's market power. In its press release announcing the settlement, the Antitrust Division trumpeted the fact that its deal with Microsoft would give future generations of middleware — cross-platform applications that could threaten Microsoft's operating system monopoly — the opportunity to compete with Microsoft products.

Well, as the saying goes, the proof is in the pudding: Here we are two years later and RealNetworks and other middleware competitors are forced to turn to Brussels and the federal courts for assistance. As for the much-vaunted settlement, it is of no relevance.

While Microsoft was settling with the Bush administration, according to RealNetworks, it was simultaneously intensifying a relentless predatory campaign to dominate the digital media player market.

This strategy so thoroughly undermined RealNetworks, the pioneer of the digital media player market, that it had no choice but to file a landmark antitrust suit against Microsoft to unlock Microsoft's increasing stranglehold over this market.

More importantly, because of its success in the digital media player market, Microsoft is poised to extend its power into digital rights management — the secure distribution of copyrighted digital content — and thereby position itself as the gatekeeper for the distribution of multi-media content.

One cannot read RealNetworks lawsuit against Microsoft without immediately noticing the striking similarities between Netscape's fate and the problems facing RealNetworks.

Like Netscape, RealNetworks gained a substantial first mover advantage over Microsoft by entering the market with a superior product years before Microsoft did. Like Netscape's browser, RealNetworks' digital media player can serve as a platform for software developers to create applications that would work on operating systems other than Microsoft. Like Netscape's browser, Microsoft perceives RealNetworks' digital media player as a potential threat to its operating system monopoly. And, as it did with browsers, Microsoft used tying as the linchpin of a predatory campaign to blunt this threat.

Familiar Scenario

For those who followed Netscape's demise closely, the predatory strategy detailed in RealNetworks' lawsuit against Microsoft is depressingly familiar.

After Microsoft's first foray into the digital media player market — NetShow — failed as a stand-alone product, Microsoft renamed its product Windows Media Player and tied it to the Windows operating system. Since May 1999, all versions of Microsoft's PC operating systems — Windows 98 Second Edition, Windows Millennium Edition, Windows 2000 Professional and Windows XP — have come with an embedded Windows Media Player.

The similarities do not end there, according to RealNetworks. As it did with Internet Explorer, Microsoft has given Windows Media Player away for free.

Moreover, Microsoft has designed its operating system to direct consumers to Windows Media Player, and consumers are effectively prevented from uninstalling or removing it from their desktops. Because Microsoft has configured Windows Media Player as the default player for all formats it supports, consumers often are prompted to use Windows Media Player, even when they have chosen another player.

To make matters worse, Microsoft has withheld or delayed access to technical information related to Windows to frustrate and make more expensive RealNetworks efforts to design products that run seamlessly on Microsoft operating systems.

Microsoft's campaign to dominate the digital media player market is working, just as its previous efforts crushed competition in the browser market. According to RealNetworks, from October 2001 through March 2003, by tying Windows Media Player to Windows, Microsoft ensured that 95 percent of all PCs that were shipped had its media player pre-installed. By contrast, RealNetworks media player was pre-installed on less than 2 percent of the more than 200 million PCs shipped during that time.

Microsoft has relentlessly exploited the inherent and unfair distribution advantage its media player enjoys to encourage content providers and software developers to adopt Windows Media formats. As a result, Microsoft has overtaken RealNetworks in the market, even though its media player was vastly inferior a short time ago.

How can Microsoft dominate new markets so quickly after it settled with the Antitrust Division? Doesn't the settlement stop it from repeating the abuses it used so effectively to disable Netscape? In a word, the answer is no.

The main reason Microsoft's settlement with the Antitrust Division does little to stop Microsoft from dominating other markets is its failure to prohibit the linchpin of its predatory tactics — its practice of tying new middleware products to the Windows operating system. In fact, the Microsoft settlement expressly permitted such tying to continue unabated when it explicitly stated that "[t]he software code that comprises a Windows Operating System Product shall be determined by Microsoft in its sole discretion." (Final Judgment, Section VI.U.)

The Bush administration justified this remarkable deference to Microsoft by contending that a prohibition against "technological tying" would chill Microsoft's product design efforts and entangle the courts in the difficult task of determining where the Windows operating system ends and the allegedly tied applications software begins.

Instead of directly addressing the antitrust issues raised by "technological tying," the Microsoft settlement uses an assortment of weak conduct remedies to prevent Microsoft from using its operating system monopoly to dominate other markets. For example, under the settlement, Microsoft must give computer manufacturers and consumers the ability to remove access to Microsoft middleware.

This provision sounds good on paper but is virtually worthless in practice. Because nearly all PCs come with Microsoft's digital media player tied to Windows, computer manufacturers are effectively dissuaded

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Jeffrey I. Shinder *is a founding partner of Constantine & Partners, a Manhattan boutique specializing in antitrust and complex commercial litigation.*

A Weekly *Law Journal* Feature

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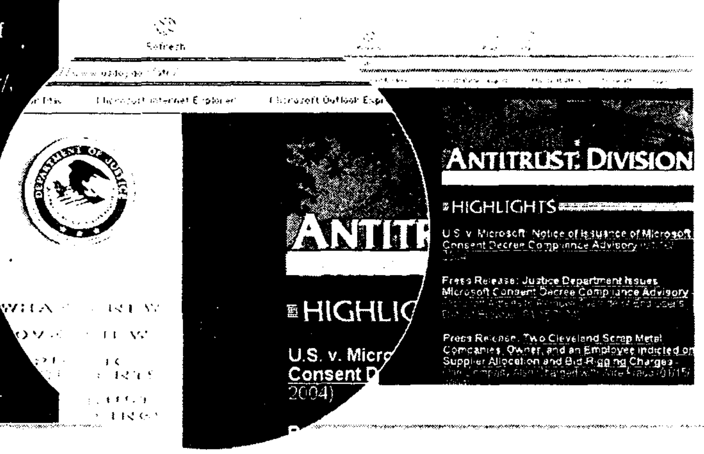
The Antitrust Division of the U.S. Department of Justice, www.usdoj.gov/atr/, offers electronic versions of selected cases and documents filed by the division since December 1994. There's also an "electronic reading room" of opinions, statements of policy and interpretations, and frequently requested records created by the division since November 1996.



from pre-installing competing players such as RealNetworks because of the prohibitively expensive support costs involved with pre-loading more than one middleware application. And consumers are not going to remove access to Microsoft's digital media player when it is the only player readily available to them.

Another Deficiency

Similarly deficient is the settlement's attempt to rein Microsoft in by forcing it to disclose certain aspects of the Windows operating system code to give competing software providers the ability to provide products that seamlessly interoperate with Windows. The settlement merely requires Microsoft to make these disclosures in a "timely manner" when it releases new versions of its operating systems. (Final Judgment, Section III.D.)

And, under the settlement, it does not even have to make these disclosures if doing so might compromise the security of various Microsoft systems. As many commentators feared when the settlement terms were released, based on RealNetworks allegations Microsoft has exploited these loopholes to harm competitors by making late or incomplete disclosures.

Such tactics reinforce the anti-competitive effects of Microsoft's tying strategy by raising competitors costs and undermining their ability to make products that work seamlessly with Windows.

As the RealNetworks complaint highlights, because of its unfettered ability to exploit its operating system monopoly, Microsoft is poised to extend its dominance to related markets where digital media technologies are used, including wireless information devices and online music delivery.

Since the Microsoft settlement appears to be worthless in the face of this onslaught, some have questioned whether any antitrust remedy can solve this problem. These naysayers ignore the fact that, when the Bush administration settled with Microsoft, many much more rigorous ideas to "fence in" Microsoft were proposed by antitrust experts and industry observers.

These included "must-carry" provisions that would have required Microsoft to carry competing middleware products in the operating system on non-discriminatory terms. More ambitious ideas included holding a one-time licensing auction for fully-paid licenses for Microsoft's operating system, or structural relief, such as breaking the Microsoft operating system monopoly into three firms. Each of these options likely would be preferable to the current situation.

Conclusion

The RealNetworks lawsuit is yet another example of how weak antitrust consent decrees, particularly those based on conduct remedies, virtually guarantee additional antitrust litigation. The settlement with Microsoft did virtually nothing to create a competitive operating system market.

RealNetworks' declining position in the digital media player market exposes the settlement's failure to "fence-in" Microsoft from repeating its sins. In short, the Microsoft settlement has failed its first important test.

But nature abhors a vacuum. Viable candidates that could step into the breach include the European antitrust authorities, who recently conducted hearings into Microsoft's practices, the states and, with RealNetworks taking Microsoft to court, private attorneys general.

The antitrust laws remain the best way to deal with public policies issues raised by Microsoft's conduct. Let's hope one of these entities has the will to enforce them.