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US V. Microsoft Settlement — 10 Years Later

Law360, New York (June 14, 2011) -- The expiration of the consent decree that settled U.S. v. Microsoft 10 years ago presents a good moment to reflect on the case that shaped antitrust law for the Internet age.

The U.S. Department of Justice, along with state attorneys general, accused Microsoft of using its agreements with PC manufacturers and Internet service providers to maintain its monopoly over PC operating systems, and extend that monopoly into Web browsing and media viewing.

To the governments, the “desktop” that greeted over 95 percent of computer owners every day was the platform on which the panoply of 21st century commerce and competition would play out — the modern equivalent of the railroads.

In fact, the governments argued, barriers to entry in the software world were even higher than for the steel, locomotives and rights of way of the old economy because the value of software platforms was so highly dependent on the number of people who used them — the so-called installed base of users and its attendant network effects.

The conditions that Microsoft put on access to its platform, such as requiring PC manufacturers not to include the rival Web browser Netscape on their PCs, threatened to chill competition in PC software generally, and raise costs for all of the businesses that used it. Microsoft, by virtue of its dominant position, must have restrictions on its behavior that smaller competitors did not.

To Microsoft and its many supporters, information technology and especially software, were different: disruptive innovation would quickly diminish the importance of the PC desktop, or any other platform for third-party development.

The Internet age was, in fact, rendering the antitrust concepts of discrete products and product markets obsolete, as formerly separate products became features of integrated systems, and software morphed from a good into a service. And innovation occurred so fast that no judicial process could hope to reach an effective solution to monopoly problems before the focus of competition shifted. Microsoft argued that market power in the software industry should be proven with direct evidence — not by market share alone, which is transient in this “uniquely dynamic” industry.

The ultimate decision and settlement of U.S. v. Microsoft, and the 10 years that followed, have proved both sides right.
At its heart, the government’s 1998 suit against Microsoft concerned its tactics in the “browser wars” of the mid-1990s. Microsoft Windows’ dominance of PC operating systems was never seriously in dispute — it ran between 80 percent and 95 percent of all personal computers, and the vast majority of PC software was written for it. Any competing operating system faced a nearly insurmountable chicken-and-egg problem of attracting

both users and application developers simultaneously — what the D.C. Circuit would come to call the “applications barrier to entry.”

Netscape Navigator — then the leading Web browser — and Sun’s Java technology challenged Windows’ dominance obliquely, by creating a “middleware” platform that could run Internet-based applications independently from the underlying operating system. While Netscape and Java didn’t threaten Microsoft’s monopoly on PC operating systems, they raised the possibility that dominance of the operating system could become irrelevant, as the “platform” for software development shifted to middleware and the Internet.

Beginning in 1995, Microsoft responded by including its own browser, Internet Explorer, in all copies of Windows, integrating its code tightly with Windows, and preventing its removal. Internally, Microsoft believed that leveraging its existing monopoly was the only way to address this threat. “I am convinced we have to use Windows — this is the one thing they don’t have,” a Microsoft executive said in an email. “We have to be competitive with features, but we need something more — Windows integration.”

In its definitive ruling on the case, the D.C. Circuit found that the “middleware” of Netscape and Java was not yet established enough to be a current check on Microsoft’s market power, but the company’s moves to exclude Netscape and Java — including its commingling of Windows and Internet Explorer code — violated Section 2 of the Sherman Act.

In a sense, this was a strong and path-breaking pronouncement by the appeals court. In another decision on Microsoft’s browser integration just three years earlier, the D.C. Circuit had suggested that combining two software programs and selling them as one product will almost never be an antitrust violation, because “any other conclusion would enmesh the courts in a technical inquiry into the justifiability of product innovations.” In the later case, when presented with evidence of Microsoft’s internal strategies (and no concrete technical justifications for the integration), the court modified its views.

What the court was not willing to do was declare technological integration of the two software programs to be a per se violation of Section 1 of the Sherman Act, as a tying claim. This, the court said, would overlook the possibility that integration could be innovative and beneficial to customers.

By rejecting the per se approach and applying the rule of reason test to cases of “technological tying,” the court allowed future defendants to prove that their deign choices were made to benefit consumers, rather than simply to exclude rivals. The subtle, but profound, shift in emphasis from the earlier appeals decision was that while antitrust courts are indeed poorly equipped to determine the value of any claimed innovation, “integration” of products could be an anti-competitive sham, one that courts could identify with sufficient evidence.

After the appeals court’s decision, Microsoft and the DOJ settled the case with a consent order that prevented many of the specific licensing practices that Microsoft had used to exclude Netscape and Java, while generally leaving the company free to integrate Internet Explorer and other features into Windows. It stayed in place until last month.

So how did the next 10 years bear out the parties’ fears, and the court’s decision? Microsoft is still the undisputed leader in PC operating systems, while Netscape and Sun disappeared from the scene by the mid-2000s. As the court predicted, the “applications barrier to entry” outlived its 1990s threats. As a remedy for past conduct, the settlement was too little, too late.

On the other hand, the scenario that Microsoft’s defense envisioned eventually came to pass, albeit with different players: Google, Facebook, Mozilla and a resurgent Apple. These competitors built on the “middleware” concept — in a new world of vastly cheaper memory, faster Internet speeds and faster wireless Internet speeds, and now tablet PCs — to create mobile and “cloud” computing platforms that are liberating many users from the traditional personal computer and thereby diminishing the importance of Microsoft’s operating system monopoly. Increasingly, the tollbooth through which new software entrepreneurs must pass is not the operating system or equipment vendor as such, but rather the creators of heavily trafficked “marketplaces” such as Apple’s App Store.

But this shift didn’t happen on “Internet time” as that phrase was understood in 2001 — that is, faster than an antitrust court could keep up. The Microsoft case “proceeded from the filing of complaints through trial to appellate decision in a mere three years.” The trends that diminished Microsoft’s role did not come to fruition until the late 2000s, almost a decade after the settlement. Innovation, it turns out, could not keep pace with antitrust litigation.

And we will never know what would have happened had Microsoft been allowed to continue to restrict distribution of rival browsers. Would Google and Facebook have been able to flourish in an environment in which users’ access could be restricted by a dominant Internet Explorer? Further, a stronger remedy against Microsoft, like splitting the company or compulsory licensing of its source code to application developers, may have brought cross-platform “cloud” computing to the fore sooner, and with even more competition.

Today, the lesson of U.S. v. Microsoft is that control of a platform on which software developers must build in order to reach customers can confer monopoly power, and the exercise of that monopoly power can harm innovation. While individual applications may come and go, control over a platform can survive many cycles of competition, even those in “Internet time.” With such power comes the risk of antitrust liability because of the potential for application platforms to remain persistent barriers to entry.

Also, since Microsoft, courts have made clear that decisions of software design are not immune from scrutiny by the courts. Strong evidence of a company’s anti-competitive intent, such as Microsoft’s now-famous threat to “cut off Netscape’s air supply,” can override judicial deference to technical or product design decisions.

In short, the legacy of Microsoft’s antitrust troubles is that the software business, though it may be transforming our economy, gets no special treatment under the antitrust laws.

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