Consumer Federation of America

For immediate release: April, 12, 2000

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CONSUMER GROUPS DEMAND EFFECTIVE REMEDIES IN THE MICROSOFT CASE

"Restore competition as quickly as possible"

Washington, D.C. – Releasing a detailed analysis of the *Findings of Fact* and *Conclusions of Law* in the antitrust case against Microsoft, the Consumer Federation of America today called on the Court to either break-up the company or impose a comprehensive set of restrictions that reigns in Microsoft's abusive business practices and gives competition a chance to take root.

The report, entitled *Facts, Law and Antitrust Remedies: Time to Hold Microsoft Accountable for its Monopoly Abuse*, points out that the Court has a duty to prescribe relief that terminates the illegal monopoly, prevents practices likely to result in monopolization in the future, and denies the defendant the fruits of its statutory violations. The Media Access Project, which has joined CFA in publishing several analyses dealing with the Microsoft, endorsed the report.

"The Supreme Court has made it clear that where such a sweeping violation of law has taken place, the court must pry open the market that has been closed to competition," said Dr. Mark Cooper, CFA's Director of Research.

"Any remedy will cause Microsoft discomfort," Cooper pointed out, "but the court based its *Conclusions of Law* on 'the full extent of the violence that Microsoft has done to the competitive process.' The Court had earlier found extensive consumer harm including slowing innovation, denying consumer choice, lowering quality, prices increases, increased consumer transactions costs and increased consumer hardware costs."

"Breaking up the company would create immediate competition and not require court oversight of company behavior," Cooper said. "Each of the new companies would be free to compete fairly, without government meddling in their business, but they would not have a dominant position or the ability to leverage market power. They certainly should know the kinds of behavior that are unacceptable."

A conduct remedy would not restore competition as quickly and would be much more difficult to implement in the long run, the report concludes. There are 20 specific practices that need to be corrected and policed. The key elements of a conduct remedy would include:

- Remedies must apply to the entire "Windows Family," desktop applications, all distribution channels and independent software vendors.
- To break down the applications barrier to entry, Microsoft should port Office to other operating systems, disclose applications interfaces, grant access to the source code, and not be allowed to use non-disclosure agreements.

- To prevent leveraging of market power, the court should require transparent prices, impose a ban on exclusive contracts and preferential deals covering, price, functionality, technical support, training, testing, marketing and other "inducements,"
- Illegal tying should be banned and a separate sales requirement imposed.
- To restrict abusive upgrade pressures, require Microsoft to maintain two-way compatibility, support older operating systems, and not raise prices on older systems.
- To allow computer manufacturers to meet consumer needs, Microsoft should permit and support boot screen and start sequence freedom.
- To rectify the extension of the monopoly, the browser should be spun off.

"Enforcement would be the key," Cooper noted, "since Microsoft showed complete disdain for the previous consent decree and the antitrust laws. This should include private rights of action to expedited proceedings with penalties for anticompetitive activity, an annual review by the court and a special master to resolve ongoing technical disputes."

The report rejects claims that a break up will hurt consumers, noting that arguments against a break-up are essentially a defense of monopoly in the industry.

- The case refutes the claim that the monopoly is the natural state of the software market, since the enduring monopoly rests on the plain old anticompetitive business practices of Microsoft.
- The new Microsoft companies will have a tremendous interest in ensuring that their operating systems remain compatible, even as they improve on them.
- To the extent it become necessary to port applications between different versions of Windows operating systems, or to other operating systems, this will be a worthwhile activity.
- For the broader industry, compatibility is a tendency against which Microsoft has fought. Microsoft has repeatedly attacked and driven products out of the market because they would increase compatibility, which threatened its monopoly.

"Creating head-to-head competition does not benefit competitors," Cooper added, "since they would face more competitors and there would be no "regulation" of the new companies' behavior for competitors to game."

"Experience in other industries suggests that real competition would produce many integrated, consumer-friendly operating systems that perform more reliably and better meet consumer needs," Cooper said. "In a world of competing systems, compatibility would become a highly valued commodity and open standards would be developed. Competitive industries center on standards that all companies can develop products for. Non-dominant firms strive for enhanced compatibility."

The report is available www.consumerfed.org/msremedies.pdf

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The Consumer Federation of America (CFA) is the nation's largest consumer advocacy group, founded in 1968. Composed of over 250 state and local affiliates representing consumer, senior citizen, low-income, labor, farm, public power, and cooperative organizations, CFA's purpose is to represent consumer interests before the Congress and the federal agencies and to assist its state and local members in their activities in their local jurisdictions.

Consumer Federation of America

FACTS, LAW AND ANTITRUST REMEDIES:
TIME FOR MICROSOFT TO BE HELD ACCOUNTABLE FOR ITS MONOPOLY ABUSES

ISSUE BRIEF

I. A PERCEIVED BENEVOLENT DESPOT PROVES TO BE A PLAIN OLD MONOPOLIST

The Microsoft antitrust trial has resulted in stunning *Conclusions of Law*. Having identified about two dozen forms of consumer harm (see Exhibit 1) that result from pervasive anticompetitive conditions and practices in the software market (see Exhibit 2), the federal district court has found that Microsoft violated the antitrust laws in three distinct and significant ways (see Exhibit 3) – by illegally maintaining a monopoly in the PC operating system market, by illegally attempting to acquire a monopoly in the Internet browser market, and by illegally tying a browser to the monopoly operating system.

A wide range of possible remedies is now being discussed. Conservatives, such as the Progress and Freedom Foundation, and liberals, such as Ralph Nader, alike have called for a break-up of the company. Others have argued that punishment should be left to private antitrust actions, which could cost Microsoft tens of billions of dollars in damage claims. During settlement negotiations, Microsoft suggested minor restrictions on its behavior.

The Supreme Court has made it clear that, having found monopolization, a federal court has a duty to prescribe relief that should "terminate" the illegal monopoly, prevent "*practices* likely to result in monopolization in the *future*,' and "*deny* to the defendant the *fruits* of its statutory violation." There is also little dispute that antitrust relief should avoid "transforming the district court into a regulatory agency."

In light of the sweeping nature of the violations of law, this paper examines two stern remedies that seem commensurate with the extent of abuse – break-up (into three operating system companies and one applications company) or a comprehensive set of conduct remedies including vigorous enforcement mechanisms. Based on these principles of antitrust law, a break-up would be a much more effective solution.

EXHIBIT 1
CONSUMER HARM

NATURE OF HARM	FINDING OF FACT (Paragraph No.)	CONCLUSIONS OF LAW (Page No.)
RETARDING INNOVATION		
Chilling Effect on Investment, Developer Time and Money	379, 397,412	
Delay or Prevent Development of Products	411, 132,395-396 22	10,18,19
Netscape's Navigator	81-88,408-410	22
IBM's OS2 / Smartsuite	116-118,125-130 10	10
Sun's JAVA	397-403	18
Real Networks	111-114	10
Apple's Quicktime	104-110	10
Intel's Native Signaling Processing	94-103	6
Undermining Compatibility	390-396, 407	6,18,19
DENIAL OF CONSUMER CHOICE		
Deny Products to Better Suit Consumer Needs	247, 410	
Delaying Release of Products	167-168	11
Deny Consumers User-Friendly Configurations	210-216	11
Force Purchase of New Versions with New PCs	57, 66	6
Deny or Delay Non-Microsoft Products	90-91,93	10,11
Thwart Responses to Consumer Demand	225-229	11,14
Forcing Consumers to Buy Non-Microsoft Products In Inconvenient Ways	133,143,203-206 239-240,247,309-311 357,359-361	11 10,15
DEGRADATION OF QUALITY		
Impair Functionality of Microsoft Products	173, 174	11
Reducing the Availability of Product	407	18,19
Impair the Functionality of Non-Microsoft Products	92,128-129, 160,171-172, 330,339,340	6,10,11,17,32
DIRECT INCREASES IN CONSUMER COST		
Short Term Revenue	57, 62-63	6
Price Discrimination / Secret Price	64,118,236-238,324	4,6,10,11
Undermining Long Term Competition	66	6
MONOPOLISTIC PRICING PRACTICES		
Hidden Price/Indirect Sales	10,18-19,58,103	4,6,10
Overcharges	62-63,66	6
Cross-Subsidy/Predation	107,137-139,261-262	10,21,22
Excess Profits	66,379	6
INDIRECT INCREASES IN CONSUMER COSTS		
Raising Consumer Transaction Cost	203-206, 239-240,247	11
Raising Hardware Costs		
Upgrade Policy	57,66	6
Excess Functionality	173-174,210-216	6,11,32

EXHIBIT 2
ABUSIVE BUSINESS PRACTICES

ANTICOMPETITIVE CONDITIONS/PRACTICES	FINDINGS OF FACT (Paragraph No.)	CONCLUSIONS OF LAW (Page No.)
MARKET STRUCUTURE		
Monopoly Position	18-21,33-35	4,5
Barriers To Entry		
Hardware	19,22-27, 54-55	4,6
Software	30,36-43,141,166	4,5,6
BUSINESS MODEL		
Under The Table		
Abrogation Of Contracts	390,394	18
Intimidation	106,129,236,355	6,10
Market Division	88,105	10,22
Patent Infringement	390,394	
Bounty	139,260,295	16,20
Predation	107,137-139,147	6,10,16,21,22
Contract Provisions		
Exclusive Deals	143,147,230-234,247 259-260,287-290,293-297 305-306,317-321 326-326,332,337 339-340,350-352	10,15,37,38
Preferred Desktop Location	139,272,301	17,20
Secret Price	64,118,236-238,324	6,10,11
Indirect Sales	10,19,103	4,6,10
Quality Impairment	90-92,128-129,160, 330,339-340	6,11
Resource Denial	240,357,379,396-406	31
Incompatibility/Integration	129,387-396,404-406	18,19
Disabling	160,170-172	11,31,32
Desupporting	90,122,128-129, 192,405-406	10,18
Bundling		
Os Tying	159, 170,198	4,11,12,31
Imitation	133-134,166	10,18,19,22

EXHIBIT 3
ABUSIVE BUSINESS PRACTICES THAT VIOLATE LAW

	CONCLUSIONS OF LAW				
	MARKET STRUCTURE		VIOLATION OF LAW		
FINDINGS OF FACT ANTICOMPETITIVE PRACTICES	MONOPOLY	APPLICATIONS BARRIER TO ENTRY	PRESERVE MONOPOLY	EXTEND MONOPOLY	TYING
UNDER THE TABLE					
Abrogation Of Contracts			*		
Intimidation				*	
Market Division	*		*	*	
Bounty		*		**	
CONTRACT					
Exclusive/Preferential		*		***	
Indirect Sales/Hidden Price	*			*	
QUALITY IMPAIRMENT	*	*		**	*
Resource Denial	*		**		
Incompatibility/Integration	**			***	
Disabling				**	**
Desupporting				**	
BUNDLING					
OS Tying				**	*
Imitation	*			*	*
PRICE ABUSE					
Discrimination/Secret Price		*		*	
Cross-subsidy/Predation			**		
Upgrade Policy		*			*
Excessive functionality		*		*	
QUALITATIVE CONSUMER HARM					
Delaying Products		*		***	*
Impairing Non-Microsoft			*		
Thwarting Responses		*		*	
Forcing Inefficient Acquisition				*	

* = cited once, ** = cited 2-3 times, *** cited 4 or more times.

II. A STRUCTURAL REMEDY IS PREFERABLE TO RESTORE AND PRESERVE COMPETITION

Breaking up Microsoft into several companies, each of which owns the operating system code would accomplish the goals of the antitrust laws in an expeditious fashion. The obvious benefits are to immediately create competition in the market. There would be no need to regulate behavior. The leverage that the single dominant firm has had over computer manufacturers and others who sell directly to the public would be undercut, since they would now have alternatives. Even if the new companies were inclined to behave in the old ways, they would lack the market power to do so.

Operating systems prices would drop, while customers would enjoy greater choice and increased innovation in operating systems. Operating systems competition likely would spawn competition in the core applications as well, with corresponding price savings and increased innovation. In addition, operating system changes would be more reflective of consumer needs.

A competitive environment would be more hospitable toward new hardware platforms and cross-platform software development. With competing browser offerings, for example, innovation in that product could revive. Overall, consumers would have significantly more choice of software and, very likely, enhanced performance and reliability.

A divestiture that created head-to-head competition in Windows would greatly reduce the amount of ongoing judicial regulation needed to preserve competition. A remedy that forced Microsoft to divest away its monopoly power would make Microsoft's conduct of less immediate competitive concern, relieving the market of much anticompetitive risk, while requiring little continuing judicial oversight.

It would also be helpful to split the applications software from the operating system software, although this is less critical to a competitive outcome. If the applications products are left with the new operating systems companies, the integrated operating system/applications companies would have an advantage, vis-à-vis other software companies, even though they would face competition among themselves. Since virtually all other software companies have been "stand-alone" applications companies (due to the Microsoft monopoly) vertical divestiture of applications is appropriate. The operating system companies would not be prevented from entering the applications business, since more competition is better. They would, however, have to develop new applications and could not use the old code, which they would not own and should not be allowed to license.

Significantly, a structural remedy that creates head-to-head competition by definition does not benefit competitors. Indeed, competitors are likely to be worse off if Microsoft is divided into several competitors, each with a share in a broad array of extremely valuable computer code and billions in cash. The consumer benefits of a structural remedy that creates direct competition are likely to come at the direct expense of competitors.

III. CONDUCT REMEDIES ARE UNLIKELY TO BE EFFECTIVE

This paper also identifies a set of conduct remedies that could be used to attempt to address the many problems indicated in Microsoft's behavior (see Exhibit ES-4). It argues that

imposing these in an effective manner would be difficult and not likely to accomplish the purpose of the antitrust laws as effectively as a divestiture.

The conduct remedy would have to be extensive, since Microsoft has engaged in such a broad range of anticompetitive practices. The policing of the remedy would have to be aggressive, since Microsoft has shown itself to be recalcitrant both in its failure to comply with the earlier consent decree and in its steadfast denial of wrongdoing in this case. Even if Microsoft obeyed the decree, competition would be slow to take root because Microsoft has dominated the operating systems market for so long.

Any conduct remedy would also have to extend to some form of licensing arrangements, in which Microsoft is forced to license the operating system code and the terms of that license are regulated by the courts for an extended period of time. This would result in a cumbersome administrative process overseen by the courts.

A comprehensive behavioral remedy would need specific provisions to address each of the anticompetitive practices that contributed to the violations of law and enforcement mechanisms that have a reasonable chance of eliciting compliance or discovering and rectifying non-compliance.

Under the Table: For certain anticompetitive practices, the Conclusions of Law stand as a remedy in themselves. The Conclusions of Law signal strongly that this conduct is not acceptable. They may trigger private and class action lawsuits. These could deprive Microsoft of one the most important fruits of its monopoly, the huge horde of cash on hand. Given the manner in which the federal case was conducted, that is the only way to get at the past fruits of monopoly conduct.

Scope: In order to overcome the barriers to entry, the remedy should be broad in scope, commensurate with the scope of the campaign Microsoft has conducted against competition. Behavioral conditions, such as disclosure requirements and prohibitions on discrimination, must apply to the entire "Windows Family" and the applications built on it. They must also apply to all aspects of the interface between Microsoft and both distribution channels and other software vendors.

Applications Barrier to Entry: In addition to the disclosure requirement, Microsoft should be required to port Office to other operating systems.

Contracting: It goes without saying that exclusive arrangements should not be tolerated. However, the Court has recognized that preferential deals are a powerful tool to preserve the monopoly. A prohibition on discrimination should apply to prices, functionalities, support, testing, marketing, and other considerations that Microsoft has used to discriminate in the past.

Quality Impairment: Porting of Office, disclosure of APIs and access to source code will all help diminish Microsoft's ability to impair the quality of competing or potentially competing products. A mechanism to ensure non-discriminatory access will be crucial. Microsoft should also be required to support older operating systems and to provide training on new operating systems.

EXHIBIT 4
CONDUCT REMEDIES FOR PRACTICES THAT VIOLATE LAW

PRACTICE	REMEDY	ENFORCEMENT
UNDER THE TABLE	Liability Under Law	Private and Class Actions
APPLICATIONS BARRIER TO ENTRY	Port office to competing OS Remedy applies to "Windows Family" Applications Distribution channels ISVs	Establish date certain Annual review by Court
CONTRACT		
Exclusive/Preferential	Ban exclusives	Annual review by Court
	Prohibition on discrimination Price Functionality Support Testing Marketing Other "inducements"	Annual review by Court
	Ban NDAs	Private right of action
Indirect Sales/Hidden Price	Transparent prices	File price schedule w/court
QUALITY IMPAIRMENT		
Resource Denial	Prohibition on discrimination	Annual review by Court
Incompatibility/Integration	Access to source code	Special master to assess
Disabling	API disclosure	Special master to assess
	Neutral warning message	Special master to assess
Desupporting	Support older OS	Annual review by Court
	Provide training	Private right of action
BUNDLING		
OS Tying	Spin off browser	Annual review by Court
Imitation	Separate sale requirement	Annual review by Court
PRICE ABUSE		
Discrimination/Secret Price	Transparent prices	Annual review by Court
Cross-subsidy/Predation	Transparent prices, separate sale	
Upgrade Policy	Restrict old OS price increase	Annual review by Court
	Backward compatibility	Special master to assess
Excessive functionality	Support older OS versions Backward compatibility	Annual review by Court
CONSUMER HARM		
Impairing Non-Microsoft	API disclosure, disclosure	Special master to assess
Thwarting Responses	Boot screen, start sequence	Private right of action
	freedom	
Forcing Inefficient Acquisition	Ban exclusives	Annual review by Court
	Prohibition on discrimination	Annual review by Court

Bundling: Microsoft should be required to spin off the browser. This is the market that was monopolized and competition could yet be restored in it. It is also an important choke point for leveraging other Internet related markets. Other bundling issues will have to be referred to a special master. However, the Court has established a clear test. Where products can stand alone, they should be required to be offered for sale separately.

Price: The conduct remedy will not place immediate downward pressure on operating system prices. Price discrimination can be eliminated with a requirement to publish a uniform pricing schedule. This will alleviate one major source of leverage over OEMs. The practice of raising the price on older versions when new ones come out should be banned. Older version should also be supported for a period. Two-way compatibility should be maintained. This will alleviate the pressure to upgrade.

Consumer Harm: As previously noted, consumer harm is the result of the anticompetitive conduct and it would presumably be rectified by effective implementation of the previous remedies. A unique consumer impact identified by the Court involves freedom to alter the boot screen and the start sequence. Not only should OEMs be allowed to do so, but Microsoft should be required to support this freedom.

Enforcement: Since enforcement is so crucial, four types of enforcement mechanisms in two broad categories – private and governmental -- are needed.

Private: One of the critical factors is to empower private individuals to take action. This reduces the extent to which enforcement must rely on the limited resources of government. With respect to past illegal behavior, there are likely to be ancillary private and class action law suits that allege antitrust violations based on the liability finding. The court should establish clear private rights of action (standing) for individuals who allege discrimination or other abuse giving them expedited remedy, protection from retribution, and access to damages should they demonstrate abuse. Banning Non-Disclosure Agreements (NDAs) should make it clear that private parties have access to code.

Government: With respect to restoring competition and preventing future monopolization an annual review by the Court should be conducted to ensure that contracting and market behaviors are in compliance in a global sense. The court could oversee a proceeding, similar to the triennial review requirement that was imposed as part of the AT&T break-up. Three years is too long to wait in the computer industry, however, and that proceeding was so cumbersome that it was followed only once in the 12 years that the AT&T decree was in effect. A second alternative would be for the court to confidentially review contracts and other agreements signed by Microsoft over the year to satisfy itself that undue discrimination is not taking place. Finally, a special master will have to be appointed to oversee more technical issues. There will inevitably be questions raised about the disclosure of API, access to source code, integration of functionalities, etc. that will require technical advice to the court.

IV. CONSUMERS WILL BENEFIT FROM RENEWED COMPETITION IN THE SOFTWARE INDUSTRY

The superiority of a structural remedy, from a legal and regulatory perspective is clear. The primary complaint about the break-up approach, from a public interest point of view, is that it opens the door to incompatible systems. Although the new companies would be starting from

a position of compatibility, these arguments claim that there is a risk that they might choose to change the code in their efforts to win customers.

At its heart, the arguments against a break-up are essentially a defense of monopoly in the industry. The trial undermines the claim that the monopoly persists because of the unique natural forces of the software market. The causes of its durability are to be found in the plain old anticompetitive business practices of Microsoft. Competition is not likely to impose the costs that its critics claim.

Since the divested companies would be starting from an installed base that represents over 90 percent of the PC market, they are unlikely to introduce changes that would cut themselves off from that base. They are likely to ensure that their operating systems remain compatible, even as they improve on them. To the extent that it does become necessary to port applications between the different versions of the Windows operating systems, this is likely to be a worthwhile activity. The chicken-and-egg problem with "competing" operating systems is that new entrants simply cannot attract enough demand to make it worthwhile for programmers to write for multiple operating systems. To the extent that a large installed base would be divided among three companies, each of the companies is likely to retain a sufficiently large base to provide an attractive market for software vendors to serve.

In fact, Microsoft has fought to against software compatibility in market after market. Over time, as Microsoft's market share has grown, it has built more and more barriers to interoperability between Windows and other operating systems or application software. Microsoft has repeatedly attacked and driven products out of the market because they would increase compatibility. It has created incompatibilities with non-Microsoft products to prevent them from becoming popular. Microsoft is not actually concerned about incompatibility; when it controls that incompatibility and it suits its business interests. At this very moment it is seeking to migrate business users to an entirely new operating systems (Windows 2000). That migration requires the very costs that Microsoft defenders claim would be unacceptable in a competitive market.

Experience in other industries suggests that real competition would produce many integrated, consumer-friendly operating systems that perform more reliably and better meet consumer needs. In a world of competing systems, compatibility would become a highly valued commodity and open standards would be developed. Competitive industries center on standards that all companies can develop products for. Non-dominant firms strive for enhanced compatibility.

V. CONCLUSION

If the court does not enter a serious remedy, Microsoft will again ignore the law or try to manipulate narrow conduct restrictions to its benefit, as it did in its 1995 Consent Decree. As revealed by documents introduced in the trial, the ink was not yet dry on the consent decree when Microsoft was already bragging that its business practices would not change as a result. That settlement failed to meet the challenge of restoring competition and consumers have paid a heavy price.

Just over a century ago the antitrust laws were adopted and applied when America was taking leadership of the world industrial economy. Break-ups of the major industrial corporations at that time were intended to prevent abuse and restore competition to the most important industries the industrial age. Claims that preventing the concentration of economic resources would hurt the economy were raised at that time and they proved to be wrong. For exactly the same reason they are wrong today at the dawn of the information age: competition is the wellspring of economic progress and technological innovation.