

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

UNITED STATES OF AMERICA,	.	
	.	CA No. 98-1232 (CKK)
Plaintiff,	.	
	.	Washington, D.C.
v.	.	March 6, 2002
	.	2:05 p.m.
MICROSOFT CORPORATION,	.	
	.	
Defendant.	.	
.....	.	

AFTERNOON SESSION
TRANSCRIPT OF TUNNEY ACT HEARING
BEFORE THE HONORABLE COLLEEN KOLLAR-KOTELLY
UNITED STATES DISTRICT JUDGE

APPEARANCES:

For the Plaintiff:

PHILLIP R. MALONE, ESQ.
RENATA B. HESSE, ESQ.
PAULA L. BLIZZARD, ESQ.
CHRISTOPHER LIND, ESQ.
U.S. DEPARTMENT OF JUSTICE
ANTITRUST DIVISION
901 Pennsylvania Avenue, NW
Washington, DC 20530
(202) 514-2413

PHILLIP BECK, ESQ.
BARTLIT BECK HERMAN
PALENCHAR & SCOTT
Courthouse Place, Suite 300
54 West Hubbard Street
Chicago, IL 60610

For the Defendant:

JOHN L. WARDEN, ESQ.
STEVEN L. HOLLEY, ESQ.
RICHARD J. UROWSKY, ESQ.
SULLIVAN & CROMWELL
125 Broad Street
New York, NY 10004
(212) 558-4000

Scott L. Wallace, RDR, CRR
Official Court Reporter

1 I understand starts Monday, and I think Your Honor wants to
2 be as fully informed as possible about the facts that
3 underlie the determination by the Court of Appeals and that
4 shows that this settlement is not in the public interest.
5 Thank you.

6 THE COURT: All right. SBC Communications,
7 Incorporated.

8 MR. FLEXNER: Good afternoon, Your Honor.

9 THE COURT: Good afternoon.

10 MR. FLEXNER: My name is Donald Flexner and I
11 represent SBC Communications.

12 We do have a special interest in this decree,
13 because we have a special interest in two things that we
14 think are part of this case and deserve protection. One is
15 and relates to our participation in Internet businesses.

16 Now, it is important to understand that this case
17 was about and is about more than middlewear threats. It is
18 about legitimate threats found in the record to the
19 Microsoft operating system monopoly.

20 Early on in the case, in the District Court and in
21 the Court of Appeals, the Department of Justice's briefs,
22 and in Microsoft's own positions, it was recognized that
23 Internet server networks could incorporate the computing
24 functions of PCs in an open architecture system in which
25 messages could be transported, applications could be

1 written without requirement of access to the operating
2 system of Microsoft. It is that part of the remedy that we
3 think must be filled.

4 Now, let me just step back for a moment and talk
5 about the context in which we find ourselves.

6 This is a case that is extraordinary; not simply
7 because we have proven findings of libel affirmed on
8 appeal. This is not an attempted monopoly maintenance
9 case, this is monopolization by unlawful exclusionary
10 conduct affirmed by the Court of Appeals. It is of
11 extraordinary duration. This is a case of monopoly power
12 that has, and maintained monopoly power that has lasted
13 over ten years. It is a case of a company which has used
14 every opportunity that it has confronted, where there was a
15 realistic possibility of erosion of its market power, to
16 address it and to address it quickly.

17 Netscape and Java were the two most immediate
18 threats. It was also recognized in the record -- and this
19 is the government's own expert -- that a good case can be
20 made that the most significant threat to Windows in the
21 next several years will come from client server
22 architectures making sure that Microsoft cannot subvert
23 this threat using undisclosed proprietary interfaces, is
24 thus central to an effective remedy. And when Microsoft
25 contested market power, they argued that client servers

1 aught to be placed in the market, and the District Court
2 rejected that because it felt that it was not, at that
3 time, a reasonable interchangeable substitute.

4 Now, we agree with the non-Settling States'
5 description of deficiencies in general, but want to focus
6 on this one thing. Before I do that, I would like to
7 address two points made by the government and made by
8 Microsoft with respect to the special causation burden.

9 You will recall that Mr. Beck's proposition is that
10 in order to earn the right to truly effective prophylactic
11 relief that would dissipate the market power that gives
12 Microsoft both the ability and the incentive to exclude,
13 there is something in the law that requires that in the but
14 for world, that is assuming that the conduct had never
15 occurred, we can show -- and they put a chart up on the
16 screen -- first, and this was only one of several
17 conditions, that Netscape and Java, absent the conduct,
18 would have been ubiquitous.

19 Now, this clearly proves too much. Microsoft was
20 successful because it killed these baby threats in the
21 crib. If you have a situation where a proven monopolist is
22 time and time again able to reach out and, to use the words
23 of the Court of Appeals, extinguish, perhaps forever, the
24 threats to the operating system monopoly in this case or
25 other monopolies in other cases, it means that that

1 especially rapacious and especially successful monopolist
2 will consistently be immune from remedies that are
3 effective to dissipate market power, and to remove the
4 incentive and the ability to engage in predation.

5 Mr. Warden argued again from the standpoint of this
6 special causation burden that would entitle the Court to
7 look beyond the two victims that were extinguished, perhaps
8 permanently, that there has to be a showing of
9 anticompetitive harm, and that clearly was shown.

10 The 12 -- remember the government's checklist, the
11 checklist of 12 things that Microsoft had done wrong that
12 the government wishes to enjoin. Each one of those 12
13 things was found and had to be found under the Court of
14 Appeals' standard to be anticompetitive, meaning precisely,^A
15 as the Court of Appeals defined it, harmful to the
16 competitive process; not to SBC, to the competitive
17 process, and harmful to consumers all 12 times. That was
18 found.

19 And I think Judge Bork is exactly right, that the
20 inference of causation in a monopolization case is always
21 present where there is liability established, and that's
22 clearly what the Court of Appeals said.

23 This is a standard that has no place in the law.
24 You cannot find it in the law and you cannot find it in the
25 D.C. Court of Appeals' opinion.

1 Now, the other pyre of relief that is terribly
2 important, and I think this is the last point that Judge
3 Bork found, is that there has to be a temporal reality to
4 it. You will recall, Your Honor, that the exclusionary
5 conduct at issue in this case took place over a period of
6 at least six years.

7 The Department of Justice decree is a five-year
8 decree, less than the course of conduct that got us to
9 where we are today. Second, second, it is a complete
10 reversal of the position that they took two years ago
11 urging ten years was the minimum that the decree had to
12 last. And it makes sense when you think about trying to
13 create a crucible where nascent competitive threats can
14 develop. It takes time. That's also reflected in the
15 appellate decision. And that time is going to be longer
16 than three or four or five years, and certainly potential
17 competitors need the confidence that a decree will give
18 them that is effective over a long enough period of time
19 for them to safely invest and compete.

20 Now, as to SBC. You will recall Mr. Beck put up on
21 the screen page 2 of our comments and pointed to the
22 partial paragraph at the top, and in particular to the
23 reference to the greater array of businesses that use
24 electronic means of communication such as telecommunication
25 services, local, long distance cellular, Internet access,

1 voice messaging, instant messaging, video, music services,
2 e-commerce and so forth and said, That's not part of our
3 case.

4 All of these things, Your Honor, all of these
5 things are imbedded, commingled, part of Windows XP.
6 There's an ad on television of a young lady who I think has
7 been grounded -- I don't watch it that closely -- but she
8 is communicating with her friends by computer, instant
9 messaging, voice over Internet, she is doing by computer as
10 advertised by Microsoft all of the things that SBC does and
11 all of the things that SBC and other competitors want to do
12 in competition with Microsoft.

13 Now, to give you two concrete examples of decree
14 deficiencies, and this is a situation where I think the
15 Court can pose specific questions to the government and to
16 Microsoft on this issue, which has to do with the freedom
17 of an internet process, which the Court of Appeals and the
18 District Court recognized were the next and perhaps
19 greatest threat to the Microsoft operating system monopoly,
20 something the antitrust laws ought to protect: One,
21 Internet Explorer, the browser, has over 90 percent of the
22 browser market. I think that's beyond dispute. 2, it is
23 defined to be a middlewear product. 3, that means that it
24 is under no obligation to make its communication protocols
25 open to the outside world. If it changes its protocols to

1 be proprietary, to work only with Microsoft servers, or to
2 work better with Microsoft servers than non-Microsoft
3 servers, we will have, SBC will have to switch to Microsoft
4 servers. Independent of that problem, there is nothing in
5 the decree -- and the government is unapologetic about
6 this -- that requires a Microsoft server to interoperate
7 with a non-Microsoft server.

8 If those two things happen; that is, an
9 interoperability between Microsoft servers and
10 non-Microsoft servers should end or degrade, or Internet
11 Explorer is able to make its interoperability less
12 efficient with non-Microsoft servers, then what will
13 happen, Your Honor, is that a present threat to the
14 Microsoft operating system in the form of an open
15 architecture server network will become part of the
16 Microsoft sea, because they will be able to control the
17 language that controls the communications and the choices
18 between browsers and servers and between servers and
19 servers.

20 Now, the government has said in its response that a
21 browser can be both middlewear and an operating system.

22 Now, if it is an operating system, and we don't see
23 this in the language, that means, according to the
24 government's decree, that the communications protocols have
25 to interface with non-Microsoft servers. We don't read it

1 that way. And so one half of the equation can be cleared
2 up by Your Honor in questions to Mr. Beck and to
3 Mr. Warden. Is it the case that Internet Explorer has to
4 make its communications protocols work with non-Microsoft
5 servers? The rest of the equation is clearly outside of
6 the decree, and it is deliberately outside of the decree
7 because, as the government says, their case did not involve
8 showing that Microsoft had a market power in servers, which
9 is true; it did not. My point is different, which is that
10 Section 2 cases decided by the Supreme Court require the
11 government in case of ten years of monopolization to
12 address and protect competitive threats like those
13 generated from the Internet where SBC wants to compete. We
14 seek no protection from competition. We seek protection
15 from the power of Microsoft to put its PCs, it's operating
16 systems between SBC and all of the businesses that SBC
17 wants to be in.

18 What we've been criticized for on page 2 of our
19 report is the business that Microsoft is now in. They are
20 doing all of those things and they are doing them in
21 Windows XP. Telecommunications and computing are
22 converging, and one of the converging technologies is
23 currently, as we stand here, currently subject to the
24 domination, the monopoly power of Microsoft continued to be
25 protected by an applications barrier.

1 Thank you very much, Your Honor.

2 THE COURT: I think at this point we should take a
3 break. This is be our afternoon break, so let me take it
4 until 25 after 3.

5 (A break had until 3:25 p.m.)

6 THE COURT: Good afternoon again. Let me hear from
7 Computer and Communications Industry Association, and I
8 believe the same lawyer is going to be speaking for
9 Software and Innovations Industry Association, so I will
10 lump them together.

11 MR. BAKER: Yes, Your Honor. Thank you. I'm
12 Stewart Baker and I'm representing both the CCIA and the
13 SIIA, and I'm acutely conscious that I'm the last speaker
14 of the afternoon, at least formally, so I have only
15 proposed to raise three points. I would like to talk first
16 about the commingling issue that was raised briefly by two
17 of the other witnesses or amicus, and then I would like to
18 turn to two other points, looking at the agreement itself,
19 first the OEM provision and then the API provision and how
20 they relate in part to the commingling issue.

21 At that point, I'll try to raise -- try to address
22 the questions you raised about the definition of
23 middlewear.

24 The commingling issue is essential to this case.
25 There isn't any doubt -- I was glad to see on the

It is . . . proper to invoke . . . the proposition that the monopolist bears the risk of the uncertain consequences created by its exclusionary acts. Thus, at the least, equitable relief properly goes beyond merely "undoing the act;" the proper relief is to eradicate all the consequences of the act and provide deterrence against repetition; and any plausible doubts should be resolved against the monopolist.

3 Areeda & Hovenkamp, Antitrust Law ¶ 653f at 102-04 (2d ed. 2002). This is the passage that states the rule this Court should follow, now that divestiture issues are out of the case. As the treatise states, some of Microsoft's exclusionary acts are "consummated" (e.g., the destruction of the Netscape and Java threats); others are "continuing" (e.g., commingling of code; failure to disclose APIs and communications protocols). Microsoft's predatory acts against Netscape and Java are "unlikely to be precisely 'repeated.'" Accordingly, "injunctive relief must be tailored with sufficient breadth" against a "'class' of acts" and acts "having a certain effect;" it must "eradicate all consequences;" "prevent repetition;" and "any doubts should be resolved *against*" Microsoft. Again, the proposed settlement totally fails to adhere to this authoritative prescription.

Moreover, even in applying the language of the Court of Appeals' discussion to this case, the government's narrow interpretation is flawed. Merely quoting the appeals court's phrases -- "tailored to fit the wrong creating the occasion for the remedy;" "an injunction against continuation of that conduct" -- does not answer the crucial question of how to *define* "the wrong" or the "conduct" giving rise to the remedy. That issue is a key to the remedy determination in this case, and is an issue of law requiring no deference by the Court to any party.

The government has accepted Microsoft's crabbed view that the "wrong" or "conduct" that may be remedied is limited exclusively to the twelve specific acts of misconduct that were inflicted on specific middleware competitors and were discussed in the Court of

Appeals opinion. (Gov't Memo in Sup. of SRPFJ at 47). A more accurate view consistent with the Microsoft III decision is that the unlawful "conduct" was Microsoft's destruction of nascent technology that threatened to break down the applications barrier to entry protecting Microsoft's PC operating systems monopoly. In other words, the "wrong" and the "conduct" addressed by the Court of Appeals are more properly described generically, in terms of the theory of the government's case, not its narrow factual underpinnings.

This interpretation is entirely consistent with the mandate enunciated by the Court of Appeals and accepted by the government, that the decree here "must seek to . . . ensure that there remain no *practices likely to result in monopolization in the future.*" Microsoft III, 253 F.3d at 103, quoted in Response ¶ 56 (emphasis added). As the Supreme Court has pointedly instructed, "the end to be served is [not] merely to end specific illegal practices." Int'l Salt Co. v. United States, 332 U.S. 392, 401 (1947). Rather, the "public interest served by [government] civil suits is that they effectively *pry open to competition a market that has been closed by defendants' illegal restraints.*" Id. (emphasis added). The government itself recognized the same thing two years ago:

a remedy limited to barring repetition of the precise acts in the precise contexts that were at issue in the [liability phase] trial could not possibly serve the required purposes of preventing recurrence of the violations and restoring competition.

(Gov't D.C.L. Reply Memo at 49). Yet by failing to ensure that the settlement protects the Internet from Microsoft's predation, the government has failed to "ensure that there remain no practices likely to result in monopolization in the future." Microsoft III, 253 F.3d at 103.

In any event, the government's belated attempt to read an insurmountable and unprecedented causation burden into the remedy determination proves far too much. For it leads to the perverse and legally insupportable result that the more successful a defendant is at

exclusion, the greater its immunity from injunctive relief to redress that violation. This result follows inexorably: Proving the existence of the "but for" world envisioned by the government -- that is, proving that Navigator or Java would have achieved "ubiquity" and attracted more ISVs than Windows -- necessarily becomes more and more difficult as the predatory conduct becomes more effective, because the quicker and greater the predator's success, the shorter and more uncertain the victim's track record becomes. As a result, under the government's theory, the monopolist that most powerfully destroys competitive threats at the earliest possible moment will be virtually immune from any injunctive relief that significantly restores competition. This outcome is even more troubling in an industry marked by "rapid technological advance and frequent paradigm shifts," Microsoft III, 253 F.3d at 79, which make repetition of the precise conduct in the same form, directed at the same targets highly unlikely. In this regard, the Court should be mindful of the government's own assessment, namely, that the two most promising middleware threats to the Microsoft monopoly are dead letter:

Through its actions against Navigator and Java, Microsoft retarded, and *perhaps extinguished altogether*, the process by which these *two middleware technologies* could have facilitated the introduction of competition into the market for Intel-compatible personal computer operating systems. (CIS at 16-17) (emphasis added).

The law allows no such absurd result. On the contrary, "a simple proscription against the precise conduct [the defendant] previously pursued" is not enough. See Nat'l Soc'y of Prof'l Eng'rs v. United States, 435 U.S. 679, 698 (1978). "A federal court has broad power to restrain acts which are of the *same type or class* as unlawful acts which the court has found to have been committed or whose commission in the future unless enjoined, may *fairly be anticipated from the defendant's conduct in the past*." Zenith Radio Corp. v. Hazeltine Research, Inc., 395 U.S. 100, 132 (1969) (emphasis added). The highlighted language precisely describes Microsoft's incentive and power to adopt the exclusionary tactics needed to suppress

competitive threats in whatever form they take. Based on the "unlawful acts" that Microsoft was found to have committed, it "may fairly be anticipated" that other acts of "the same type or class" will occur. Given developments in the computer industry over the past decade, such acts are far more likely to occur in the world of servers and Internet interoperability, than in the context of middleware that was a main focus at trial.

The government has negotiated -- and now defends -- a decree that is based on this fundamental misconception of the law of antitrust remedies. Ironically, that position also disregards that the founder and chairman of Microsoft fully recognized the potential threat to its operating system monopoly that the government now says it cannot prove. As established by this Court's findings, Mr. Gates "warned . . . that Netscape was 'pursuing a multi-platform strategy where they move the key API into the client to *commoditize* the underlying operating system.'" United States v. Microsoft Corp., 84 F. Supp. 2d 9, 26 at ¶ 72 (D.D.C. 1999) (hereafter "FOF ¶ ___") (emphasis added).

Because the legal standard applicable to the determination of relief is an issue of law, the Court owes no deference to the government's legal interpretation. And because the government's agreement to the most important terms of the settlement rests on a fundamental error of law, the government's balancing of the pros and cons of the settlement deserve no deference. By making this error, the government has effectively admitted that it negotiated from an indefensible legal position of such extreme weakness that the outcome is not in the public interest.

II. INTERNET-BASED PRODUCTS AND SERVICES WERE PART OF THIS CASE THROUGHOUT THE TRIAL AND APPEAL

The government and Microsoft have claimed repeatedly in defending the settlement that Internet-related relief is far outside the scope of this case. The government took

SBC specifically to task at the Tunney Act hearing for arguing that any decree should "constrain Microsoft in how it can compete in . . . other markets" "such as telecommunications services (local, long distance and cellular), Internet access, voice messaging, instant messaging, video and music services, e-commerce, interactive games." (Tr. 17, quoting SBC Comments at 2). The reason the decree does not and should not cover these areas, the government claims, "is because we are constrained by the case that we put on and the case that we proved and the case that was upheld by the Court of Appeals." (Tr. 17).³

Again, the government is wrong. Its position is flatly contradicted by the record, which is replete not merely with evidence, but with express Findings of Fact, that demonstrate the nascent competitive threat that is posed to Microsoft's monopoly by technologies such as server operating systems, handheld devices, cell phones, television set top boxes and Internet services. The Findings of Fact further establish the need for a remedy to protect these technologies. And as this Court has recognized, "the facts that were found on the liability phase are on the record and . . . binding on the court." (Tr. of Feb. 15, 2002, 11:50 a.m. at 28).⁴

Although this Court and the Court of Appeals properly held that these technologies were not at the time of trial sufficiently advanced to be "reasonably interchangeable" substitutes for the Windows-powered PC, and thus were not presently able to

³ Somewhat inconsistently with the government's position in opposing Internet-related relief, the proposed settlement provides that Microsoft must disclose "Communications Protocols" that are used by the Windows operating system to communicate with servers running on Microsoft operating systems (see CIS at 36-40). The government claims that this provision will "protect opportunities for the development and use" of competing middleware by ensuring that the non-Microsoft servers on which it runs can communicate ("interoperate") with Microsoft PCs (CIS at 38). At the Tunney Act hearing, Microsoft's counsel expressly agreed with the government's interpretation that the settlement required Internet Explorer to be treated as an operating system product as well as middleware, so that both its communications protocols and its APIs would be disclosed (Tr. 153-55; 165-66; 186; Response ¶ 315).

⁴ See *Christianson v. Colt Ind. Oper. Corp.*, 486 U.S. 800, 817 (1988) ("courts should be loathe" to revisit prior decisions absent "extraordinary circumstances such as where the initial decision was clearly erroneous or would work a manifest injustice"). Here, of course, the findings of fact cannot possibly be erroneous because they remain undisturbed following comprehensive appellate review.

constrain Microsoft's power within the relevant operating system market, there is no basis for claiming (as the government now does) that merely because they are not part of the market definition that the government successfully proved, they cannot be part of the remedy. Indeed, the reverse is true. It was only because these technologies were in their infancy that this Court and the Court of Appeals agreed they had no present ability to constrain Microsoft's operating system monopoly. See United States v. Microsoft Corp., 87 F. Supp. 2d 30, 36 (D.D.C 2000); Microsoft III, 253 F.3d at 52. But it is precisely because these technologies are developing, nascent threats that they need protection -- just as Netscape and Java did -- from Microsoft's illegal and exclusionary conduct.

On the subject of competitive technologies, this Court found as a fact that is now "binding" in the remedy phase of the case (Tr. of Feb. 15, 2002, 11:50 a.m. at 28):

The exponential growth of the Internet represents an inflection point born of complementary technological advances in the computer and telecommunications industries. The rise of the Internet in turn has fueled the growth of server-based computing, middleware, and open-source software development. *Working together, these nascent paradigms could oust the PC operating system from its position as the primary platform for applications development and the main interface between users and their computers. Microsoft recognizes that new paradigms could arise to depreciate the value of selling PC operating systems; however, the fact that these new paradigms already exist in embryonic or primitive form does not prevent Microsoft from enjoying monopoly power today If Microsoft exerted its power solely to raise price, the day when users could turn away from Windows without incurring substantial costs would still be several years distant. Moreover, Microsoft could keep its prices high for a significant period of time and still lower them in time to meet the threat of a new paradigm. Alternatively, Microsoft could delay the arrival of a new paradigm on the scene by expending surplus monopoly power in ways other than the maintenance of high prices.* (FOF ¶ 60) (emphasis added).

The Court found as well that "the growth of server-based . . . software development" might eventually weaken the applications barrier to entry because "[a]s the bandwidth available to the average user increases, 'portal' Web sites, which aggregate Web