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IN THE UNITED STATES DISTRICT COURT  
FOR THE DISTRICT OF COLUMBIA

**FILED**

MAR 11 2002

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U.S. DISTRICT COURT

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UNITED STATES OF AMERICA,	x
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	:
Plaintiff,	:
	:
v.	:
	:
MICROSOFT CORPORATION,	:
	:
Defendant.	:
	x

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Civil Action No. 98-1232 (CKK)

**REPLY MEMORANDUM OF SBC COMMUNICATIONS INC.  
IN OPPOSITION TO THE PROPOSED FINAL JUDGMENT**

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3 Areeda & Hovencamp, <u>Antitrust Law</u> (2d ed. 2002).....	5, 6-7, 17
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**INDEX OF ABBREVIATIONS USED TO REFER TO COURT DECISIONS,  
PROCEEDINGS AND PLEADINGS IN THIS CASE**

CIS	Competitive Impact Statement, filed by the Department of Justice in <u>United States v. Microsoft Corp.</u> , Nos. 98-1232, 98-1233 (CKK). 66 F.R. 59492 (Nov. 28, 2001).
FOF	Findings of Fact entered by the District Court on November 5, 1999. <u>United States v. Microsoft Corp.</u> , 84 F. Supp. 2d 9 (D.D.C. 1999).
Gov't D.Ct. Memo	Plaintiffs' Memorandum in Support of Proposed Final Judgment, filed in the District Court on April 28, 2000 (corrected May 2, 2000).
Gov't D.Ct. Reply Memo	Plaintiffs' Reply Memorandum in Support of Proposed Final Judgment, filed in the District Court on May 17, 2000.
Gov't D.Ct. Sum. Resp.	Plaintiffs' Summary Response to Microsoft's Comments on Revised Proposed Final Judgment, filed in the District Court on June 5, 2000.
Microsoft Memo in Support of SRPFJ	Defendant Microsoft's Memorandum in Support of the Second Revised Proposed Final Judgment, filed in the District Court on February 27, 2002.
Microsoft Revised Proposed Findings	Defendant Microsoft's Revised Proposed Findings of Fact, filed in the District Court on September 10, 1999.
Plaintiff's Proposed Revised Findings	Plaintiff's Revised Proposed Findings of Fact, filed in the District Court on September 10, 1999.
Response	Response of the United States to Public Comments on the Revised Proposed Final Judgment, filed by the Department of Justice on February 27, 2002.
SBC Comments	Comments of SBC Communications Inc. on the Proposed Final Judgment, filed with the Department of Justice on January 28, 2002.
Settling States Memo	Memorandum of Law of the Settling States in Support of the Proposed Final Judgment, filed in the District Court on February 27, 2002.
SRPFJ	Second Revised Proposed Final Judgment. The proposed settlement entered into by the United States and the Settling States with Microsoft, filed in the District Court on February 27, 2002.
Tr.	Transcript of Tunney Act Hearing Before the Honorable Colleen Kollar-Kotelly, <u>United States v. Microsoft Corporation</u> , No. 98-1232, March 6, 2002.
Tr. of Feb. 15, 2002, 11:50 a.m.	Transcript of Telephonic Status Conference Before the Honorable Colleen Kollar-Kotelly, <u>New York et. al v. Microsoft Corp.</u> , No. 98-1233, February 15, 2002 at 11:50 a.m.

## INTRODUCTION

The fundamental issue confronting the Court is whether the proposed settlement is adequate to prevent Microsoft from preserving and expanding its illegally maintained monopoly of PC operating systems. The Court must determine, for example, whether the public interest can possibly be served -- in the most important government antitrust case in a generation -- by a settlement that makes no serious attempt to protect what is proven in the record of *this case* to be among the most promising nascent threats to Microsoft's illegally maintained monopoly: Internet- or web-based products and services. By ignoring such competitive threats to Microsoft's monopoly and focusing exclusively on middleware, the proposed settlement fails of its essential purpose.

Contrary to the contentions of the settlement's proponents, Internet-based threats are not outside the record of this litigation. They were featured prominently in the liability phase of the trial, and were recognized by this Court and the Court of Appeals as a powerful potential threat to the Microsoft operating system monopoly. Thus, the government's effort to justify its failure to protect such nascent threats is wrong as a matter of law.

As an Article III court entering a judgment after a full trial on the merits and a finding of Section 2 liability affirmed on appeal, this Court is not bound to defer to the Department of Justice's flawed legal position. The Court should not enter a decree that, on the binding record of fact findings affirmed on appeal, fails to meet the most basic principles of antitrust relief as defined by the Supreme Court. The proposed settlement fails because it would allow Microsoft to repeat the same predatory behavior in destroying Internet-based threats to the Windows monopoly that it used to destroy middleware threats.

This glaring omission is not accidental. The very first sentence of the government's "explanation of the proposed final judgment" states the settlement's goal as merely

“to restore the competitive threat that middleware products posed prior to Microsoft’s unlawful conduct,” along with “eliminat[ing] Microsoft’s illegal practices” and “prevent[ing] recurrence of the same or similar practices.” CIS at 17. The government thus has abandoned any effort to anticipate or address different “practices” having the same objective of maintaining Microsoft’s monopoly by attacking other likely threats, such as the Internet server threat that was part of the liability case itself. The government’s error is highlighted by the views expressed by its co-plaintiffs, the nine “Settling States,” which stress that a remedy must “prohibit the *foreseeable means* by which Microsoft might again use its monopoly power to crush future nascent middleware threats.” (Settling States Memo at 8; emphasis added). On this record, Microsoft’s attack on the Internet server threat is not merely “foreseeable,” it is likely, because Microsoft itself has recognized the threat (see pp. 13-14 *infra*) and has the incentive and ability to act against it.<sup>1</sup>

The government claims that its limited settlement is compelled because the Court of Appeals affirmed only the “specific theory” of monopoly maintenance in the PC operating system market and suppression of middleware threats, while rejecting claims of “leveraging that monopoly in order to get an unfair advantage in other markets” (such as the voice messaging and telecommunications services of particular concern to SBC). See Tr. 19. The “leveraging” argument is a red herring. Microsoft’s predatory attacks on nascent middleware threats caused

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<sup>1</sup> The government itself admitted in the earlier remedy proceedings that in framing “appropriate equitable relief” one “must anticipate that Microsoft, unless restrained . . . likely will continue to perpetuate its monopoly by the same anticompetitive methods revealed at trial, *although directed at whatever new competitive threat arises.*” (Gov’t D.Ct. Memo at 27-28) (emphasis added). There is absolutely nothing in the Court of Appeals decision that compels any change in this philosophical framework governing the scope of relief. Nevertheless, in the current proceeding and in its response to the Tunney Act comments, the government has displayed an almost fanatical emphasis on “middleware” as the sole focus of relief, going so far as to assert that even protecting competing non-Windows operating systems (*i.e.*, the most direct victims of Microsoft’s monopolization) is beyond the scope of the case. See Response ¶ 322 (“Nor is it appropriate for the remedy to focus on competing operating systems vendors . . .”).

obvious collateral damage to applications software markets; for example, Microsoft threatened to reduce the availability of non-Windows applications, such as word processing software for the Apple operating system, as part of its campaign to extinguish rival browsers. See United States v. Microsoft Corp., 253 F.3d 34, 72-73 (D.C. Cir. 2001) (en banc) ("Microsoft III"). But that collateral impact on other markets does not convert the government's section 2 middleware case into a leveraging case to protect the applications market.

Similarly, when SBC and many other commenters complain that the settlement does not address Microsoft's ability and incentive to maintain its operating system monopoly by squelching newly-expanding assaults on its dominance, such as server- and Internet-based threats, they are not making a leveraging claim. To be sure, if Microsoft is able to "extinguish" the Internet-based threats to its operating system monopoly, it will also capture control of the *applications* and *devices* that depend on server networks, including UMS, VoIP, instant messaging, PDAs, cellular phones and the like. But such collateral damage is simply a hallmark of successful monopoly maintenance, just as injury to software applications was the necessary consequence of extinction of the middleware threat. The "leveraging" term of art thus has no responsible application to SBC's concerns and to the proposed settlement's deficiencies.<sup>2</sup>

At the end of the day, the omission from the settlement of meaningful protection for server- and Internet-based threats or for other non-middleware assaults on Microsoft's monopoly, adamantly defended by the government on untenable legal grounds, alone requires

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<sup>2</sup> For obvious practical reasons, using the colloquial term "leveraging" to describe the effects of Microsoft's monopoly maintenance conduct is easier in some contexts than explaining how Microsoft's abuse of the applications barrier to entry maintains its PC operating system monopoly. But using that colloquial shorthand in a press interview to describe the damage caused to other markets by Microsoft's *illegal monopoly maintenance* (as government counsel chastised SBC for doing, Tr. 172-73), does not place that criticism outside the case. Regardless of the collateral effects in adjacent markets, the settlement must, at a minimum, prevent Microsoft from maintaining or expanding its PC monopoly by eliminating competition emanating from such markets.

rejection of the proposed settlement. In addition, the settlement fails to serve the public interest because of other glaring omissions and ambiguities. These deficiencies are not cured by the government's interpretive explanations in the Competitive Impact Statement and in its response to the Tunney Act comments. Indeed, Microsoft's counsel refused to accept those interpretations when pressed by the Court at the Tunney Act hearing, thereby leaving it open to Microsoft to challenge the meaning of key settlement terms in later enforcement proceedings. Moreover, the settlement's five-year term is palpably insufficient. The government has never provided a meaningful rationale for a decree term that not only violates its own express policy, but is shorter than the time period during which Microsoft used exclusionary and anticompetitive conduct to destroy any and all threats to its monopoly as quickly as they emerged.

Finally, nothing in the Tunney Act requires this Court to cede its independent authority and responsibility to determine whether the public interest can be satisfied by a decree whose scope and duration are woefully inadequate to accomplish the purposes of relief in Section 2 monopoly maintenance cases. As the Supreme Court has held, a "trial court is charged with inescapable responsibility to achieve" those requirements. United States v. United Shoe Machinery Co., 391 U.S. 244, 250 (1968).

**I. THE SETTLEMENT IS PREMISED ON THE GOVERNMENT'S  
FLAWED VIEW OF THE APPLICABLE LEGAL STANDARD**

The government admits that its settlement of a fully-adjudicated monopolization case must meet the "requirements of an antitrust remedy" as established by the Supreme Court and described by the Court of Appeals in this case:

a remedies decree in an antitrust case must seek to "unfetter a market from anticompetitive conduct," *Ford Motor Co. [v. United States]*, 405 U.S. [562,] 577 [(1972)], to "terminate the illegal monopoly, deny to the defendant the fruits of its statutory violation, and ensure that there remain no practices likely to result in monopolization in the future," *United States*

*v. United Shoe Mach. Corp.*, 391 U.S. 244, 250 . . . (1968); *see also United States v. Grinnell Corp.*, 384 U.S. 563, 577 . . . (1966).

(Response ¶ 56, quoting Microsoft III, 253 F.3d at 103).

The government goes on, however, to ignore the plain meaning of this admonition by focusing entirely on snippets of restrictive language, taken out of context, from various cases (*see* Response ¶ 57). This argument culminated at the Tunney Act hearing when government counsel read to the Court from the Court of Appeals in this case:

Absent such causation, the antitrust defendant's unlawful behavior should be remedied by "an injunction . . . against continuation of that conduct."  
[3 *Areeda & Hovencamp*, Antitrust Law] ¶ 650a at 67.

(Tr. 23-24, quoting Microsoft III, 253 F.3d at 106). From this language and related discussion in the opinion, the government concludes that, in order to obtain injunctive relief that would *reduce Microsoft's monopoly power*, rather than merely prohibiting twelve "specific illegal acts" of monopoly maintenance and allowing "middleware threats" to reach the same nascent stage of development which they had before Microsoft extinguished them, it would be required to prove that *but for* the extinction of these middleware threats, Microsoft's monopoly would have "dissipated" (Tr. 25-26). Illustrating the point, government counsel claimed that in order "to justify a remedy beyond an injunction of the offensive conduct," such as a remedy limiting Microsoft's power to control the Internet, the government would have had to prove that in a "but for" world, "Navigator and Java would have been successful programs and would have achieved *ubiquity*" (Tr. 26-27) (emphasis added).

Not only is the government's reading of Microsoft III untenable, but its theory of prophylactic injunctive relief, requiring proof of a "but for" world in which Netscape and Java actually diminish Microsoft's market power, collides with long-established Supreme Court precedent. *See United Shoe*, 391 U.S. at 245, 251 (where monopolist has excluded competition,

courts have a "duty . . . to assure the complete extirpation of the illegal monopoly"). Such a theory also means, contrary to law, that the most successful monopolists, which are able to kill each nascent threat before it can leave the crib, are permanently insulated from relief that reduces monopoly power at its source (Tr. 150-51).

A fair reading as a whole of the "Remand" section of the Court of Appeals opinion on which the government bases its causation argument, see Microsoft III, 253 F.3d at 105-07, demonstrates that the primary focus was on the remedy of divestiture, as the Court itself observed (Tr. 28-29). Even in the three paragraphs from which government counsel quoted extensively, divestiture is the focus. See Microsoft III, 253 F.3d at 106-07 ("particularly remedies such as divestiture;" "it may well conclude that divestiture is not an appropriate remedy"). From this context, it is clear that the Court of Appeals' discussion of the necessity for heightened proof of causation cannot be blindly applied, as the government urges, to non-structural conduct relief.

Similarly, the Areeda treatise that the Court of Appeals quoted repeatedly in the "Remand" portion of Microsoft III, and that the government heavily relied on in its oral argument, contains a far more specific discussion of injunctions relevant to the present relief determination than the book's other comments which, like the Court of Appeals discussion, generally address divestiture remedies. In the more relevant portion, the treatise states:

When a monopolist has consummated an exclusionary act or has been continuing an exclusionary practice, equitable relief beyond a mere injunction against repetition of the act is generally appropriate. We must also try to undo the various effects of that act. Further, the specific act under challenge may be unique to the circumstances and unlikely to be precisely "repeated." As a result, injunctive relief must be tailored with sufficient breadth to ensure that a certain "class" of acts, or acts of a certain type or having a certain effect, not be repeated.

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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. 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).<sup>3</sup>

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).<sup>4</sup>

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

<sup>3</sup> 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).

<sup>4</sup> 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

content and provide services such as search engines, E-mail, and travel reservation systems, could begin to host full lines of the server-based, personal-productivity applications that have begun to appear in small numbers on the Web." FOF ¶¶ 60, 27. The Court also made detailed findings about the operations of network and Web servers. FOF ¶¶ 24-26.

Based on these findings alone, undisturbed by the Court of Appeals, any remedy imposed by this Court must include provisions that protect the "nascent paradigms" of "Internet . . . fueled . . . server-based computing, middleware, and open-source software" from repetition of Microsoft's illegal conduct. See FOF ¶ 60; *Microsoft III*, 253 F. 3d at 79. Moreover, this Court has already expressly found that unless and until these "embryonic" paradigms can grow into full-fledged competitors, Microsoft will enjoy the economic rewards of its monopoly power for "several years," bilking consumers during that period (i.e., the present) with high prices or using its monopoly power to degrade service or raise rivals' costs. FOF ¶ 60. The law demands that such conduct be stopped.

In addition to these "binding" Findings of Fact, the record also contains extensive admissions by Microsoft that Windows competes with these "emerging technologies," although they are "relatively immature now":

Microsoft faces the constant threat of competition from emerging technologies, such as operating systems for hand-held devices and network computers. Microsoft recognizes this threat and is responding to it by developing innovative operating system technology. New classes of microprocessor-based computing devices -- such as television set-top boxes, hand-held computers, wireless telephones and game consoles -- do not run desktop operating systems. These devices, commonly called "information appliances," are rapidly becoming powerful enough to perform a wide range of computing functions and sufficiently inexpensive to attract significant numbers of users.

Microsoft Revised Proposed Findings ¶¶ 227-228 (citations omitted).

Microsoft admitted “[t]he very real prospect of a paradigm shift towards such non-PC devices.” *Id.* ¶ 235. It recognized that because “non-PC devices perform functions currently performed by personal computers (such as e-mail, Internet access, address books and scheduling), these non-PC devices are increasingly important substitutes for personal computers and offer robust competition for the attention of ISVs.” *Id.* ¶ 231. Similarly, Microsoft admitted “[t]he growth and significance of server-based applications,” as “the Web (and networks generally) have become an increasingly important locus of applications.” *Id.* ¶¶ 286, 289. In terms of time frame specifically, Microsoft acknowledged that “since the conclusion of the trial” in June 1999, “the shift to Web-based applications has continued and achieved marked prominence.” *Id.* ¶ 291. That admission, made in September 1999, has only been greatly reinforced by developments in the succeeding 2½ years.

Finally, Microsoft went so far as to recognize expressly that the “applications barrier to entry” could be “destroy[ed]” by the “well-documented trend toward server and Web-based applications.” *Id.* ¶ 293. The government also admitted in its proposed findings that “web-based applications” were a “potential threat,” albeit one that Microsoft could “vitalize . . . by gaining a substantial share of browsers and then using proprietary extensions.” Plaintiff’s Proposed Revised Findings ¶ 47.2.

Thus, the concerns expressed by SBC, far from being outside the monopoly maintenance case successfully prosecuted by the government, stand at its core. Given the Government’s recently adopted, artificially-cabined view of the relief required in this case, it is perhaps understandable that its counsel focused at the hearing on SBC’s concern that the proposed settlement would not prevent Microsoft from using its PC operating system monopoly power to reduce consumer choice in all businesses that utilize electronic means of

communication (see p. 11, supra, quoting Tr. 17). As SBC's counsel later pointed out, however, the markets for these products and services are very much a part of this case, as evidenced by Microsoft's current operating system product, Windows XP, which was released just prior to the proposed settlement and incorporates, either by commingling code or by bundling, features and services (i.e., Media Player, MSN, Internet Explorer, Messenger, Hotmail, Gaming Zone, Passport, .NET) that place Microsoft squarely in every single market described in SBC's Comments (see Tr. 152-53).

### III THE SETTLEMENT'S FIVE-YEAR TERM IS NOT IN THE PUBLIC INTEREST

Many commenters, including SBC, sharply criticized the proposed settlement because its provisions -- limited and flawed as they are -- would only constrain Microsoft's behavior for five years (see SBC Comments at 107-11). Particularly in view of the Antitrust Division's express policy that it "should not *negotiate any decree* of less than 10 years' duration" (Department of Justice, Antitrust Division Manual, ch. IV at 54 (3d ed. 1998); emphasis added); the government's admission that "[t]en years is customary in antitrust cases" (Gov't D.Ct. Summ. Resp. at 20); and the fact -- not disputed by the government -- that there has never been a decree of less than ten years' duration involving an adjudicated section 2 violation, one would expect the government to have powerful justifications for its position.<sup>5</sup>

The government's Response to the Tunney Act comments, however, reveals nothing of the sort, and perhaps fearing to invite questions for which there is no good answer, the

<sup>5</sup> The government does not dispute that, with a single exception, no consent decree in a section 2 case since 1978 (when the Antitrust Division Manual changed the prior policy of seeking unlimited duration decrees in section 2 cases) has been less than ten years (see SBC Comments at 109-110 & n. 33). The single reported exception was the first decree obtained against Microsoft, which was entered without any adjudication of liability. But if that exception proves anything, it is that a decree must be both powerful enough and long enough to prevent the kind of violations committed by Microsoft even while the first decree was in effect.

government did not even mention the issue at the Tunney Act hearing. Instead, the government's Response states the obvious: "there is no scientific way to determine the optimal term of a consent decree," and the government's position "is a matter of judgment informed by experience" (Response ¶ 411). Of course, one would have thought that the directive of the Antitrust Division Manual not to "negotiate any decree of less than 10 years" represented the collective "judgment" and "experience" of decades of dedicated antitrust enforcement. The government points to the Manual's opening comment that decrees generally "should be fashioned to fit the particular facts of the case." (Response ¶ 412) But if this truism, applicable to all aspects of any decree, is held to trump the very specific direction not to "negotiate" a shorter a decree, then the Manual is virtually meaningless as a guide to principled government action.<sup>6</sup>

The only justification suggested by the government beyond the admission that the truncated duration was "the product of negotiation" is that the "market" is "conducive to rapid change." (Response ¶ 411) That fact, however, would rationally justify a longer decree, not a shorter one, to ensure that "embryonic" competitive threats have enough time to develop and flourish. Any concern about drastic changes in competitive conditions could be allayed by including in a ten-year decree a simplified procedure for the defendant to seek modification or termination. Indeed, it is precisely because no "measuring stick" can predict the future with "scientific" accuracy (Response ¶¶ 411-12), that the governing principle should be Professor

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<sup>6</sup> The government also cites six cases in which five-year decrees were entered (Response ¶ 412 nn. 381, 382), and Microsoft cites another (Microsoft Memo in Support of SRPEJ at 33-34 n. 24). None of them, however, involved section 2 monopolization claims; nor had there been trial proceedings in any of them, let alone findings of fact affirmed on appeal. Rather, all of the cited cases involved garden-variety settlements of conspiracy, exclusive dealing and merger cases.

Areeda's admonition that "any plausible doubts should be resolved against the monopolist" (see pp. 6-7 supra) by requiring a ten-year decree.

Moreover, notwithstanding the rapid pace of technological change, Microsoft's monopoly power has persisted for over a decade, and Microsoft has adapted its predatory tactics to crush new threats as quickly as they appear. In addition, the exclusionary tactics adopted by Microsoft extended at least for six years, making it clear that a decree which fails to cover at least the same period cannot serve, much less protect, the public interest. Microsoft's proven record of abuse, when coupled with the "judgment" and "experience" embodied in the Antitrust Manual and the burden of proof that the Areeda treatise argues should be placed upon the monopolist in the event of "doubt," makes the case for a ten-year decree overwhelming.

The difference between five years and ten years is far more than the usual matter of degree. It is a real and substantial difference in kind, and it destroys any public interest rationale for the proposed settlement of this monopolization case.

#### IV. GLARING OMISSIONS AND DEFICIENCIES IN THE PROPOSED SETTLEMENT ARE INIMICAL TO THE PUBLIC INTEREST

The settlement's failure to prevent Microsoft from maintaining its operating system monopoly by extinguishing the threat posed by Internet-based computing alone requires rejection of the proposed settlement. Numerous other omissions and ambiguities, however, make its entry inimical to the public interest as well.

A. **Failure to End Commingling.** The proposed settlement admittedly would allow Microsoft to continue to "commingle" or bind computer code for middleware to the Windows operating system, although OEMs and end-users would have to be allowed to remove the icons for Microsoft middleware from the desktop and to feature competing products. The Microsoft middleware, however, would continue to exist in the PC's hard drive and be accessible

to applications programs. (Response ¶¶ 227-30; SRPFJ § III.H.1). Although commingling was expressly condemned by the Court of Appeals (Microsoft III, 253 F.3d at 64-67), and roundly criticized by commenters (see, e.g., SBC Comments at 41-67), the government claims that the ability to remove middleware icons is all that is required (Response ¶¶ 225-35).

The government is wrong. First, while the Court of Appeals addressed removing the "visible means of end-user access," its opinion went much further. It condemned Microsoft's commingling of code both because it imposed increased support costs on OEMs if they load additional middleware (as the settlement allows them to do) and degraded operating system quality overall. See Microsoft III, 253 F.3d at 64-67. Because the proposed settlement fails to address these anticompetitive consequences of commingling code, it is plainly inadequate. Moreover, in arguing that the absence of a remedy for commingling is not a retreat from its previous position (Response ¶ 227), the government ignores the fact that one reason it had initially requested a structural remedy was to address this very issue. By separating Microsoft into an operating systems company and an applications company, it would have structurally ended commingling. Thus, the terms of the initial decree are inconsistent with the government's present position.

Finally, commingling gives Microsoft several unique advantages that the proposed settlement fails to eliminate: (1) Microsoft's in-house software developers will have access to the APIs and other technical information long before outside programmers, allowing them extra time to create and perfect software; (2) because the commingled middleware is still physically in the computer, even if end-user access is not visible, its APIs remain a ubiquitous attraction for new software applications and in this way continues the applications barrier to entry; and (3) the increased costs to OEMs resulting from loading additional middleware onto the

PC operating system, which were condemned by the Court of Appeals, Microsoft III, 253 F.3d at 64-67, remain undisturbed.

**B. Severely Limited Interoperability Provisions.** In response to arguments that the settlement provisions designed to protect the “seamless interoperability” between Microsoft software programs and competing software are gravely flawed (*see, e.g.*, SBC Comments at 62-91), the government claims that such concerns “are well beyond the scope of the case.” (Response ¶324). That position is, however, flatly contradicts the undisturbed findings of this Court and the government’s own argument during the initial remedy proceeding:

Microsoft can hardly argue that client/server interoperability issues are unrelated to the trial. In the first place, its own expert, Dean Schmalensee, testified that control over the browser could enable a firm to “severely” affect the functionality of server applications . . . . Second, having argued during the trial that Microsoft lacked monopoly power in the operating-systems market because of the future potential of server-based applications, Microsoft can hardly contend now that it should be free to frustrate the threat to the Windows monopoly posed by such server-based applications by withholding critical information needed for those applications to interoperate with Windows.

Gov’t D.Ct. Reply Memo at 49 (internal citations omitted).

As discussed above, this Court’s findings compel relief to protect the threat that server-based computing and hand-held devices (PDAs, cellphones, set-top boxes) pose to the Windows monopoly by effectively functioning as competitive alternatives to Windows PCs. That threat, however, will be stillborn if interoperability disclosures are limited – as they now are even with the clarification made by the government at the Tunney Act hearing (Tr. 165-66) – to the PC-server interface. See SBC Comments at 69, 76-78. Nor has the government adequately responded to the concerns that the disclosures of APIs and communications protocols, as those terms are defined in the proposed settlement, are inadequate to allow ISVs to achieve “seamless interoperability.” See SBC Comments at 78-80.

An equally serious flaw exists in the definitions of "Microsoft Middleware" and "Windows Operating System Product," which effectively give Microsoft complete control over whether particular software is in each category. If Microsoft uses that control to remove the software from the category, it can manipulate its disclosure obligations to anticompetitive effect. For example, if Microsoft chooses not to distribute separately or trademark Internet Explorer ("IE"), then IE would no longer be "Middleware" and thus not subject to API disclosure obligations. (SRPFJ § III.D). Similarly, if Microsoft decided it no longer wanted to disclose IE's communications protocols for interoperability with servers, it could simply decide, "in its sole discretion," not to distribute IE as part of the operating system. (SRPFJ §§ III.E and VI.U). More disturbingly, Microsoft is free to manipulate these product definitions at will, so that it can disclose APIs or protocols for a particular product at one time but not at another. As a result, ISVs and Internet services designers will never know if a product they develop will always interoperate properly with Windows PCs.

Microsoft's ability to manipulate these definitions has been demonstrated once again in recent months. In response to criticism that Windows Media Player 8.0 was initially offered only as a bundled product with Windows XP (thereby avoiding disclosure of its APIs, even though media players are a classic example of middleware and had qualified as such in earlier, separately distributed versions) (SBC Comments at 38, 84-85), Microsoft announced, for the first time, through its counsel at the Tunney Act hearing, that "we are about to again distribute a version separately from the operating system" (Tr. 182). While that may make Media Player middleware subject to API disclosure, if it is also unbundled from the operating system (counsel's remarks are sufficiently ambiguous to allow for this), then its protocols would

no longer be disclosed and music distributors using non-Microsoft servers would (if Microsoft switches to a proprietary protocol) be unable to reach Windows PC customers.

In sum, neither the government nor Microsoft have, or can, categorically state that during the entire duration of the proposed settlement, all of the APIs, communications protocols and other technical information necessary for non-Microsoft servers to interoperate seamlessly with PCs will be disclosed. As a result, the uncertainty generated by actions taken "in Microsoft's sole discretion" will discourage ISVs from writing applications for competing middleware and non-Microsoft servers.

C. Inadequate Protection against Retaliation. The government claims that the settlement's retaliation provisions are "logically" limited to OEMs, ISVs and IHVs because these are the only entities that Microsoft has subjected to retaliation in the past. (Response ¶¶ 135, 243). This explanation essentially condones Microsoft's retaliation against anyone else in the industry. Given Microsoft's ability and incentive to retaliate, such actions are surely "foreseeable means by which Microsoft might again use its monopoly power to crush future nascent middleware threats." (Settling States Memo at 8).

The government also claims that "retaliation" need not be defined, because "it carries the clear meaning of taking adverse actions." (See SBC Comments at 96; Response ¶ 240). But because the term "adverse action" is much broader than the word "retaliation," the government's gloss cannot be accepted, at least without express agreement by Microsoft. Particularly because the victim of retaliation will have the burden of proof, the standard must be clear. The government also claims that no ban on threats of retaliation is needed because "[t]hreats . . . are empty when Microsoft cannot follow through on them." (Response ¶¶ 136, 241). This, however, ignores the fact that threats of retaliation often have the

same anticompetitive impact whether or not they can be implemented. The government's argument unrealistically assumes that the victim will call Microsoft's bluff on the possibility that it could prove retaliation in subsequent litigation.

**D. License Royalties.** The government takes issue with SBC's criticism that licenses required under the settlement to ensure interoperability should be royalty-free (see SBC Comments at 85-88), arguing that "disclosure of APIs in the manner that Microsoft typically does it (c.g., through MSDN and not via a license) . . . would occur at no cost." (Response ¶ 347). This argument is insupportable. The Findings of Fact amply show that, when allowed, Microsoft will manipulate its market power to achieve anticompetitive ends. Its anticompetitive behavior has included intentionally withholding APIs, protocols and other technical information to injure potential competitors. Merely because Microsoft does not now charge a royalty is meaningless as proof that it will not do so when the settlement allows it, and it is certain that such royalties would sound the death knell for nascent competition.

The government also "does not believe that the scaled-back liability that the Court of Appeals upheld justifies requiring Microsoft to give away its valuable intellectual property" (Response ¶ 348). Conspicuously absent from this statement is any identification of how "scaled-back liability" justifies the government's complete reversal of position.<sup>7</sup> To the contrary, the Court of Appeals' decision did not question, in any respect, the relevant findings that Microsoft predatorily withheld technical information to maintain its operating system monopoly.

**E. Ambiguities in Settlement Terms.** At the Tunney Act hearing, the Court asked Microsoft in straightforward fashion whether it agreed with the government's

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<sup>7</sup> The government's position in the initial remedy proceedings was completely contrary to its view today: "[t]here is . . . no need or justification to charge a royalty for access to the same information about interoperation . . . that Microsoft's own developers receive." (Gov't D.C.L. Sum. Resp. at 14).

interpretations of the scope and meaning of each provision of the proposed settlement, as set forth in the government's CIS and Response to the Tunney Act comments (Tr. 81-82). As the Court recognized, the question is crucial because "those documents spend quite a bit of time explaining how the provisions operate" (Tr. 82), and many of those explanations are essential to clarify ambiguities that were strongly criticized by many Tunney Act comments and would otherwise compel rejection of the settlement. See Mass. Sch. of Law at Andover, Inc. v. United States, 118 F.3d 776, 783 (D.C. Cir. 1997) (proposed consent judgment should be rejected "if any of the terms appear ambiguous"). After initially denying that the government's interpretations were binding or even probative (Tr. 82; "We believe the consent judgment speaks for itself and has to be interpreted on its face"), Microsoft never answered the Court's question unequivocally in the affirmative, and in fact disclaimed the ability to do so (Tr. 83-84).

Because of the critical importance of the proposed settlement to the American economy and to consumers, the Court should require Microsoft to set forth, in writing, precisely where it agrees or disagrees with each and every one of the government's interpretations. The issue of whether, as the Court put it, there is a "meeting of the minds" (Tr. 81-82), is an exacting issue of contract interpretation, not some metaphysical concept to be debated later in an unsuccessful contempt proceeding, as occurred in Microsoft I. Yet that is exactly the outcome that the artful equivocation of Microsoft's counsel presages (see Tr. 84: "There is, you know, a meeting of the minds up-in-the sky sense of the word," but differences exist that "would have [a] bearing on the court's decision"). Absent Microsoft's complete and unequivocal answer to this Court's question -- and even that might be ineffective to bind the company, see United States v. Armour & Co., 402 U.S. 673, 681-82 (1971) -- the Court cannot base its public interest determination on the government's interpretive documents, which go far beyond the text of the

proposed decree. Yet without those interpretations, there can be no doubt, as shown in numerous comments, see, e.g., SBC Comments at 32-107, that the decree fails the public interest test because it is either fatally ambiguous or does not, absent the interpretations, provide essential relief.

### CONCLUSION

As noted at the outset, entry of the proposed consent decree is a judicial act entrusted to this Court by Article III of the Constitution. As a result, the deference that the Court must afford to the government's advocacy of the settlement is limited by separation of powers. In particular, even if the government's position were not flawed by errors of law and fact (see Points I and II above), the Court need not and should not defer to the government or anyone else in performing uniquely judicial tasks, including: (1) interpreting the Court of Appeals decision; (2) applying the prior factual findings of this Court to the remedy determination; (3) evaluating the factual and legal theories on which the trial record was developed; and (4) determining whether the proposed settlement fulfills the mandate established by Supreme Court precedent for complete relief in a case of proven section 2 violations.

Based on these principles, the government's deference argument goes too far. The problem is easily illustrated. Assume that the proposed decree only provided (as Microsoft argued was all that was warranted under the Court of Appeals' decision (Tr. 69)) that for five years Microsoft would not repeat any of the twelve unlawful acts of monopoly maintenance found by the Court of Appeals. Under the government's rule of deference, the Court would be obliged to approve the settlement even though it knew, on the record of this case, that the remedy did not meet two of the three standards for antitrust relief established by the Supreme Court -- such a remedy would fail to prevent the recurrence of exclusionary conduct adapted to extinguish

new threats to the Microsoft monopoly and would fail to "pry open to competition a market that has been closed by defendants' illegal restraints." Int'l Salt Co., 332 U.S. at 401.

Because the Court has the Constitutional duty to ensure that any judgment it enters meets the standards imposed by the Supreme Court, it cannot grant deference to the degree the government asserts. That is why Judge Greene had no trouble rejecting the AT&T consent decree as contrary to the public interest because it permitted AT&T to "discriminate against competi[tors] in a variety of ways" in the nascent electronic publishing market. United States v. Am. Tel. & Tel., 552 F. Supp. 131, 181 (D.D.C. 1982), aff'd sub nom. Maryland v. United States, 460 U.S. 1001 (1983). See also id. at 185 ("[U]nder the Sherman Act . . . restriction [was] necessary to permit the development of competition in that market.") (quoting Ford Motor Co. v. United States, 405 U.S. 562, 577-78 (1972)). And because significant deficiencies make it impossible for the proposed decree in this case to meet two of the Supreme Court's three criteria for a proper antitrust judgment, the proposed settlement should not be approved.

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Respectfully submitted,



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**CERTIFICATE OF SERVICE**

I hereby certify that on this 11<sup>th</sup> day of March 2002, I caused true and correct copies of the foregoing Reply Memorandum of SBC Communications Inc. in Opposition to the Proposed Final Judgment to be served via hand delivery upon:

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