Testimony of

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Chairman Leahy and distinguished Members of this Committee, thank you for inviting me to testify before you today on the important issues relating to the settlement of the case against Microsoft, brought by the Antitrust Division of the United States Department of Justice, 18 States and the District of Columbia. New York is one of the lead States in this lawsuit, and we have had a central role in the matter going back to the investigation that led to the filing of the case.

As the members of the Committee know, on Friday, November 2, 2001, the DOJ and Microsoft reached a proposed settlement of the lawsuit, which was then publicly announced. After further negotiations between Microsoft and the States, a revised settlement was reached on Tuesday, November 6, 2001. New York -- together with the States of Illinois, Kentucky, Louisiana, Maryland, Michigan, North Carolina, Ohio and Wisconsin -- agreed to the revised settlement. The remaining State plaintiffs -- California, Connecticut, Florida, Iowa, Kansas, Massachusetts, Minnesota, Utah, West Virginia and the District of Columbia -- are seeking a judicially ordered remedy, as is their right.

I, together with an Assistant Attorney General from the State of Ohio, were the principal representatives of the States in the lengthy negotiations that led to the proposed final judgment embodying the settlement. Therefore, I believe that we in New York see the Microsoft settlement from a vantage point that others who were not in the negotiating room may lack. I will do my best to try to share our observations with the Committee. I will begin by presenting an overview of the lawsuit and the settlement reached. After that, I will address in more detail several of the central features of the settlement. Then, I wish to turn to the settlement process itself, particularly insofar as it bears on criticism of the proposed final judgment.

1. Overview of the Case and the Settlement

In May 1998, New York, 18 other States and the District of Columbia began a lawsuit against Microsoft, alleging violations of federal and state antitrust laws. The States' case was similar to an antitrust case commenced that same day by DOJ, and the two cases proceeded on a consolidated basis. In summary, the litigation against Microsoft charged that the company unlawfully restrained trade and denied consumers choice by: (1) monopolizing the market for personal computer ("PC") operating systems; (2) bundling (or "tying") Internet Explorer -- Microsoft's web browser -- into the Windows operating system used on most PCs; (3) entering into arrangements with various industry members that excluded competitive software; and (4) attempting to monopolize the market for web browsers.
After a lengthy trial, the District Court upheld the governments' claims that Microsoft had unlawfully: (1) maintained a monopoly in the PC operating system market; (2) tied Internet Explorer to its Windows operating system monopoly; and (3) attempted to monopolize the

browser market. The District Court issued a final judgment breaking up Microsoft into two separate businesses, and ordering certain
conduct remedies intended to govern Microsoft's business activities pending completion of the break-up. These remedies were stayed while Microsoft appealed.
In June of this year, the Court of Appeals for the District of Columbia Circuit issued its decision on appeal. United States v. Microsoft Corp., 253 F.3d 34 (D.C. Cir. 2001). The Court of Appeals broadly upheld the lower court's monopolization maintenance ruling, although it rejected a few of the acts of monopolization found by the District Court including the Court's determination that Microsoft's overall course of conduct itself amounted to monopoly maintenance. On the tying claim, the Court of Appeals reversed the lower court's holding of an antitrust violation, and ordered a new trial under the rule of reason -- a standard more favorable to Microsoft than the standard previously used by the trial court. In view of these rulings, the Circuit Court vacated the final judgment, including the break-up provisions. Finally, the Court of Appeals disqualified the trial judge from hearing further proceedings. Thereafter, the Court of Appeals denied a rehearing petition by Microsoft, and the Supreme Court declined to hear an appeal by Microsoft concerning the Court of Appeals' disqualification ruling.

The Court of Appeals returned the case to the District Court in late August of this year. At that point, a new judge -- Hon. Colleen Kollar-Kotelly -- was assigned. Shortly after that, DOJ and the States announced their intention, in the forthcoming proceedings before the District Court, to refrain from seeking another break up order -- and to focus instead on conduct remedies modeled on those included in the earlier District Court judgment. DOJ and the States also announced that they would not re-try the tying claim under the rule of reason test that the Court of Appeals had adopted. These decisions by the government enforcers were made in an effort to jump-start the process of promptly obtaining a strong and effective remedy for Microsoft's anticompetitive conduct, as upheld by the Court of Appeals' decision.

The parties appeared before Judge Kollar-Kotelly for the first time at a conference held on September 28, 2001. The Court directed the parties to begin a settlement negotiation and mediation process, which would end on November 2. Specifically, the Court noted that "I expect [the parties] to engage in settlement discussions seven days a week around the clock in order to see if they can resolve this case." (Transcript of September 28, 2001 proceedings, page 5) The Court also adopted a detailed schedule governing the proceedings leading to a hearing on remedies, which the Court tentatively set for March 2002, if no settlement could be reached.

The settlement process that the District Court thus set in motion resulted in a proposed final judgment agreed to by Microsoft , DOJ and nine of the plaintiff States. The overarching objective of this settlement is to increase the choices available to consumers (including business users) who seek to buy PCs by promoting competition in the computer and computer software industries. More specifically (and as I will explain further below), the proposed final judgment includes the following means to increase consumer choice and industry competition:

Microsoft will be prohibited from using various forms of conduct to punish or discourage industry participants from developing and offering products that compete or could compete with the Windows operating system, or with Microsoft software running on Windows.

Microsoft will be prohibited from restricting the ability of computer manufacturers to make significant changes to Windows, thereby encouraging manufacturers to offer consumers more choice in the features included in PCs available for purchase.

Microsoft will be required to disclose significant technical information that will help industry participants to develop and offer products that work well with Windows, and, in this way, potentially aid in the development of products that will compete with Windows itself.

Microsoft will be subject to on-site scrutiny by a specially selected three-person committee, charged with responsibility to assist in enforcing Microsoft's obligations under the settlement, and to help resolve complaints and inquiries that arise by virtue of the settlement.

New York decided to settle the Microsoft case because we believe that the deal hammered out over the many weeks of negotiations will generate a more competitive marketplace for consumers and businesses throughout the country, and, indeed, throughout the world. In summary, the settlement that the parties have submitted to the District Court for approval will accomplish the following:

2. Empowering Computer Manufacturers to Offer Choices to Consumers

First, the proposed final judgment will empower computer manufacturers -- the "OEMs" -- to offer products that give consumers choice. Under the settlement, OEMs have the opportunity to add competing middleware to the Windows operating system in place of middleware included by Microsoft. (Section III, paragraphs C and H) Middleware here refers not only to software like the Netscape browser, one of the subjects of the liability trial, but also to other important PC functions, such as email, instant messaging, or the media players that enable consumers to receive audio and visual content from the Internet. (Section VI, paragraphs K and M) Middleware is important, in the context of this case, because it may help break down barriers that protect Microsoft's Windows monopoly.
The government negotiators insisted on, and eventually obtained, a broad definition of middleware so that the proposed decree covers both existing middleware and middleware not currently in existence, but which Microsoft and its competitors may develop during the term of the decree. The reason for our pressing a broad definition is plain enough: the broader the definition of middleware, the more software covered by the settlement, and the greater the opportunity for a software product to develop in a fashion that challenges the Windows monopoly.

Under the proposed decree, OEMs will have the ability to customize the PC's that they offer. They may, for example, add icons launching both competing middleware -- and products that use competing middleware -- to the Windows desktop or Start menu, and to other places in the Windows operating system. OEMs also will have the ability to suppress the existence of the competing middleware that Microsoft included in the Windows operating system licensed to the OEM. Microsoft itself will have to redesign Windows to the extent needed to permit this sort of substitution of middleware, and to ensure that the OEMs' customization of Windows is honored. (Section III, paragraphs C and H)
The options available to OEMs under the settlement mean that the Windows desktop is up for sale. Companies offering a package of features that includes middleware, and middleware

developers themselves, who desire to put their product into the hands of consumers can go to OEMs and buy a part of the real estate that the Windows desk top represents. This opportunity for additional revenue should further empower OEMs to develop competing computer products that offer choice to consumers.

The OEMs' ability to offer consumers competing middleware is backed up by a broad provision that prohibits Microsoft from "retaliating" against OEMs for any decision to install competing middleware (as well as any operating system that competes with Windows). (Section III, paragraph A) This provision forbids Microsoft from altering any of its commercial relations with an OEM, or from denying an OEM a wide array of product support or promotional benefits, based on the OEM's efforts to offer competitive alternatives. (Section VI, paragraph C) Then, to back up the non-retaliation provision, Microsoft also is required to license Windows to its 20 largest OEMs (who comprise roughly 70% of new PC sales) under uniform, non-discriminatory terms. (Section III, paragraph B) Microsoft also is prohibited from terminating any of its 20 largest OEMs for Windows licensing violations without first giving the OEM notice and an opportunity to cure the alleged violation. (Section III, paragraph A)

3. Empowering Software Developers and Others to Offer Competing Middleware

Second, the proposed final judgment seeks to encourage independent software developers -- referred to as "ISVs" -- to write competing middleware. This is accomplished by forbidding Microsoft from retaliating against any ISV based on the ISV's efforts to introduce competing middleware or a competing operating system into the market. (Section III, paragraph F) The literally thousands of ISVs in the industry are protected by this additional non-retaliation provision, and they are protected whether or not they have an on-going business relationship with Microsoft. ISVs, and many other industry participants, are further protected by provisions that prohibit Microsoft from entering into exclusive dealing arrangements relating to middleware or operating systems. Exclusive dealing arrangements are a device that Microsoft used to deny competitors access to the distribution lines needed to enable their products to gain acceptance in the marketplace. (Section III, paragraphs F, G) We have effectively closed off that practice to Microsoft.

4. Requiring Microsoft to Disclose Information to Facilitate Interoperation

Third, the proposed final judgment requires Microsoft to provide the technical information -- "interfaces" and "protocols" -- that industry members need to enable competing middleware to work well with Windows. Middleware uses functions of the Windows operating system through connections or "hooks" called "applications programming interfaces" -- "APIs" for short. Microsoft will now be required to disclose the APIs that its own middleware uses to interoperate with Windows, and to provide technical documents relating to those APIs, so that ISVs who wish to develop competing middleware will have the information needed to make their products work well with Windows. (Section III, paragraph D)

This is, again, a place where the broad definition of middleware, covering both existing and yet to be developed products, matters. (Section VI, paragraph J) The broader the definition, the greater the number of APIs that Microsoft must disclose and document. The greater the technical

information made available, the greater the
likelihood that industry participants will be able to develop competing middleware that works well on Windows.
The proposed decree goes beyond requiring disclosure of APIs between Windows and Microsoft middleware. More and more, at-home consumers and computer users in the workplace can obtain functionality that they need from either the Internet or from network servers operating in a business setting. This trend means that computer applications running on servers may be an emerging location for developing middleware that could challenge the Windows monopoly at the PC level. Thus, the settlement is designed to prevent Microsoft from using Windows to gain competitive advantages in the way that PCs talk to servers. This is accomplished by requiring Microsoft to disclose, via a licensing mechanism, what are called "protocols" used to enable PCs and servers to communicate with each other. (Section III, paragraph E)

This particular provision -- sometimes referred to as the "client/server interoperability" section -- was especially important to the States. The provision included in the November 2 version of the final judgment between the DOJ and Microsoft did not seem to us in New York to go quite as far as we felt it needed to go. As a result, this was a place that we and other States focused on in the negotiations leading to the revised settlement signed on November 6. The changes that resulted did not involve many words, but we believe that they enhanced Microsoft's disclosure obligations in this critical area.

5. The Enforcement Mechanism

The subject matter of the Microsoft lawsuit is complex, and so too are many parts of the remedy embodied in the final judgment. This complexity creates the potential for good faith disagreement, as well as for intentional evasion. For this reason, from the outset of the settlement negotiations, New York held to the view that enforcement provisions going beyond those typically found in antitrust decrees would be needed here. We worked closely with DOJ to achieve this objective. What you find in the proposed final judgment is an enforcement mechanism that we believe is unprecedented in any antitrust case.

The proposed consent decree expressly recognizes the "exclusive responsibility" of the United States DOJ and the antitrust officials of the settling States to enforce the final judgment against Microsoft. (Section IV, paragraph A (1)) To assist this federal and state enforcement and compliance effort, the proposed decree will create a three person body, the "Technical Committee" or "TC." (Section IV, paragraph B) The TC is empowered, among other things: (1) to interview any Microsoft personnel; (2) to obtain copies of any Microsoft documents -- including Microsoft's source code -- and access to any Microsoft systems, equipment and physical facilities; and (3) to require Microsoft to provide compilations of documents, data and other information, and to prepare reports for the TC. (Section IV, paragraph B(8)(b), (c)) The TC itself is authorized to hire staff and consultants to carry out its responsibilities. (Section IV, paragraph B(8)(h)) Microsoft also is required to provide permanent office space and office support facilities for the TC at its Redmond, Washington campus. (Section IV, paragraph B(7)) In other words, for the five year term of the decree, the TC will be the on-site eyes and ears of the government enforcers. The TC and government enforcers may communicate with each other as often as they need to, and the TC may obtain advice or assistance from the enforcers on any

matter within the TC's purview. In addition, the TC is subject to specific reporting requirements -- every six months, or immediately if the TC finds any violation of the decree. (Section IV, paragraph B(8)(e), (f)) The TC further will be expected to field and promptly resolve complaints and inquiries from industry members, or from government enforcers themselves. (Section IV, paragraph B(8)(d), paragraph D)

All of this will be paid for by Microsoft, subject to possible review by federal and state officials, or the Court. To discourage Microsoft from mounting dubious court challenges to the TC's costs and expenses, the proposed decree authorizes the TC to recover its litigation expenses, including attorneys' fees, unless the Court expressly finds that the TC's opposition was "without substantial justification." (Section IV, paragraph B(8)(i))
These enforcement provisions are probably the strongest ever crafted in an antitrust case. Federal and state enforcers will have at their disposal their regular enforcement powers, which may be invoked at any time independent of anything that the TC may do. (Section IV, paragraph A(2), (4)) Meanwhile, the TC will augment these traditional powers in significant respects. In addition, Microsoft itself is required to appoint an internal compliance officer to assist in assuring discharge of the company's obligations under the settlement. (Section IV, paragraph C)

I am mindful that concern has been expressed regarding the enforcement provision that "[n]o work product, findings or recommendations of the TC may be admitted in any enforcement proceeding before the Court . . . ." (Section IV, paragraph D(4)(d)) But the impact of this provision should not be great. As noted, the TC may report to the government enforcers, who may use the TC's work to seek from Microsoft a consensual resolution of, for example, any non-compliant conduct, to initiate (and inevitably shortcut) enforcement-looking activity, to pursue leads, and for other enforcement purposes. Moreover, the TC's work product, once known, should be readily susceptible of prompt replication by enforcement officials for use in judicial proceedings.

6. The Settlement Process

As the very fact of these hearings attests, the proposed settlement of the Microsoft case is a subject of significant public interest and debate. For years, many have asserted that the case itself should never have been filed to begin with. For these individuals, the government should be satisfied to get any remedy at all. We in New York profoundly disagree with this view. As the liability trial and appeal confirmed, this case was properly brought to remedy serious anticompetitive activity by Microsoft. The trial and appellate proceedings further confirmed that the antitrust laws are alive and well in technological industries, just as they are in other parts of our nation's economy. Accordingly, the public is entitled to a strong, effective remedy.

In this regard, however, some have criticized the settlement for not going far enough, or for having exceptions and limitations. We reject this view as well.
In announcing the decision by New York and eight other States to settle the case, New York Attorney General Eliot Spitzer noted that "a settlement is never perfect." A settlement is an agreed-upon resolution of competing positions and objectives. Do I wish that the DOJ and the States had gotten more? Of course I do. Do our counterparts on the Microsoft side wish that they had given up less? There is no doubt about the answer. So, asking these questions does not take us very far. Settlement necessarily means compromise. It is in the nature of the beast.

This particular settlement is the product of roughly five weeks of consuming negotiations, much of which took place under the guidance of two experienced mediators. I am unaware of any calculation of the total person-hours consumed by this effort. Certainly it was in the thousands, if not tens of thousands, of hours. The process required the two sides to explore, both internally and in face-to-face negotiations, a host of factors that bear on terms of the settlement eventually reached, such as: (1) the competitive consequences of varying courses of action; (2) the design, engineering and practical implications and limitations of various remedy approaches, as well as their impact on innovation incentives; (3) the issues actually framed for trial in the liability phase of the case and their resolution by the Court of Appeals; (4) the law governing remedies for the monopoly maintenance violation that the Court of Appeals upheld, which the District Court would be called on to apply in the absence of a settlement; and (5) the resources, effort and time otherwise needed to resolve the sharp factual disputes that would be presented in a full-blown remedies hearing. New York and the other States, as well as the DOJ, were aided in this process by experienced staff and retained experts.

In the final analysis, the DOJ, New York and the other settling States concluded that the benefits to consumers and to the competitive process that are likely to result from the negotiated settlement reached here outweigh the uncertain remedy that a contested remedies proceeding might bring. In assessing the soundness of that conclusion, the members of the Committee should recall that the settlement's critics have a luxury that those of us who settled did not have: they have the settlement floor created by the final judgment that we have offered. Absent this settlement, however, a judicial remedies hearing had not simply potential rewards, but significant risks as well.
During the September 28 court conference, the District Court expressed its views regarding the appropriate scope of the conduct remedies that might emerge from a judicial hearing on relief. Among other things, the District Court stated the following:

The Supreme Court long ago stated that it's entirely appropriate for a district court to order a remedy which goes beyond a simple prescription against the precise conduct previously pursued . . . . The Supreme Court has vested this court with large discretion to fashion appropriate restraints both to avoid a recurrence of the violation and to eliminate its consequences. Now, case law in the antitrust field establishes that the exercise of discretion necessitates choosing from a range of alternatives.

* * *
So the government's first and most obvious task is going to be to determine which portions of the former judgment remain appropriate in light of the appellate court's ruling and which portions are unsupported following the appellate court's narrowing of liability.

Now, the scope of any proposed remedy must be carefully crafted so as to ensure that the enjoining conduct falls within the number [sic, penumbra] of behavior which was found to be anticompetitive. The government will also have to be cautiously attentive to the efficacy of every element of the proposed relief.

(Transcript of September 28, 2001 proceedings, pages 9, 8)
These remarks highlight risks that both sides confronted if the decision were made to press for a court-ordered remedy. Several concrete examples, from the settlement actually reached, will

further drive home this point.
Microsoft's API disclosure obligations, and its obligations to permit OEMs to customize the Windows desktop and operating system more generally, revolve around a series of related middleware definitions that the parties agreed to. Absent a settlement, there could no assurance that the courts would adopt middleware definitions as broad as those that DOJ and the settling States negotiated.

The liability trial in the case centered on Microsoft's conduct directed to efforts by Netscape and Sun to get Netscape's web browser and Sun's Java technologies installed on individual PCs. Plaintiffs' theory of the case -- which the trial and appellate courts upheld -- was that these forms of middleware could, if sufficiently pervasive at the PC level, erode the applications barrier to entry that protects Microsoft's Windows monopoly. Microsoft therefore set out to exclude this middleware from PCs. In the settlement negotiations leading to the client/server interoperability provision, the government negotiators argued that applications running at the server level can be analogous to middleware running at the PC level. On this approach, middleware developed at the server level could also break down the applications barrier to entry into the PC operating system market. Therefore, the remedy in this case requires Microsoft to disclose ways that PCs running Windows talk to servers running Microsoft software. Absent a settlement, however, there could be no assurance that the courts would order disclosure of this PC/server line of communications. Microsoft resisted this provision during the settlement negotiations, and would similarly have opposed it at a remedies hearing.
Finally, as I noted above, there does not seem to be any antitrust precedent for an enforcement mechanism that puts a monitor on site, with full access to the defendant's documents, employees, systems and physical facilities -- all at the defendant's expense. Absent a settlement, Microsoft would have vigorously opposed such a far-reaching enforcement regime, and there plainly could be no assurance that the courts would have ordered comparable relief.
As these examples reflect, I believe that the proposed final judgment compares favorably to -- and in some respects may well exceed -- the remedy that might have emerged from a judicial hearing.

The existence of a settlement has also accelerated the point in time at which a remedy will begin to take effect. Microsoft has agreed to begin complying with the proposed final judgment starting on December 16, 2001. (November 6 Stipulation, paragraph 2) Assuming further that the District Court approves the proposed final judgment in Tunney Act proceedings in early 2002, there will be a remedy in place a year or more before the trial and appellate level proceedings, needed to resolve the appropriate remedy in the absence of a settlement, would be concluded. In this rapidly changing sector of the industry, the timeliness of a remedy is an important consideration.

6. Conclusion

In sum, the settlement in the Microsoft case promotes competition and consumer choice. It is proportionate to the monopoly maintenance violations that the Court of Appeals for the District of Columbia Circuit sustained. The settlement represents a fair and reasonable vindication of the public interest in assuring the free and open competition that our nation's antitrust laws guarantee.
Microsoft is reported recently to have issued a companywide email stating its commitment to

making the settlement "a success" and to "ensuring that everyone at Microsoft complies fully with the terms" of the decree. D. Ian Hopper, Associated Press State & Local Wire (Nov. 30, 2001). We expect nothing less, and we intend to see to it that Microsoft honors that commitment. New York is one of the members of the States' enforcement committee, created under the proposed decree. Our State Antitrust Bureau will be vigilant in monitoring Microsoft's discharge of its obligations, and we look forward to working closely with the DOJ to make sure that the settlement is, indeed, a success. The American public is entitled to nothing less.