Testimony of

Mr. Jonathan Zuck

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INTRODUCTION

Good morning, Mr. Chairman and members of the Committee. I am Jonathan Zuck, President of the Association for Competitive Technology, or ACT. On behalf of our member companies, it is my sincere honor to testify before this committee today. As a professional software developer and technology educator, I am grateful for this opportunity and appreciate greatly your interest in learning more about the effects of the proposed settlement entered into by the United States Department of Justice (DOJ), nine state attorneys general and Microsoft on our industry. ACT is a national, Information Technology (IT) industry group, founded by entrepreneurs and representing the full spectrum of technology firms. Our members include household names such as Microsoft, e-Bay and Orbitz. However, the vast majority of our members are small and midsize business, including software developers, IT trainers, technology consultants, dot-coms, integrators and hardware developers located in your states. The majority of ACT members cannot hire lawyers and lobbyists or fly to Washington to have their views heard. Therefore, they look to ACT to represent their interests. To be sure, to meet the needs of our broad constituency, we don't always agree with our members, even Microsoft, on some policy issues.

I have a great deal of respect and sympathy for the plight of these small technology companies, because I spent over fifteen years running similar companies. During this time, I've managed as many as 300 developers, taught over a hundred classes, and worked on some interesting projects. I was responsible for a loan evaluation application for Freddie Mac, an automated Fitness Report application for the Navy and a Regional Check Authentication system for the Department of Treasury. I have built software on multiple platforms include DOS. DR-DOS, OS/2 and Windows using tools from many vendors including Microsoft, Oracle, Sybase, Powersoft, IBM, Borland and others. I remain active as a technologist and last year designed a system to get to your corporate data wirelessly. I have also delivered keynotes and other presentations at technical conferences around the world.

While ACT members vary in their size and businesses, they share a common desire to maintain the competitive character of today's vibrant technology sector that has been responsible for America's "new economy." Unfortunately, for the last three years, the tens of thousands of small businesses in the IT industry have been virtually ignored during the government's investigation and prosecution of Microsoft.

I believe the settlement, on balance, is good not only for the bulk of the IT industry, but for consumers as well. Voters also see the value in the settlement. Voter Consumer Research conducted polls of 1,000 eligible voters last month in Utah and Kansas that are quite telling. In Utah and Kansas, when asked if their state attorney general should pursue the case after the DOJ settlement had been reached, the respondents said, by a 6 to 1 margin, that they should not.

As one of the "techies" on this panel, I look forward to getting into more "real life" effects of the proposed settlement to prove this point.

With that backdrop, my testimony today is focused on describing how the settlement will foster competition for thousands of America's small IT companies and how that, in turn, will benefit consumers.

THE STATE OF OUR INDUSTRY

Before we discuss life in a post Microsoft settlement world, I must speak to present-day competition and innovation. I want to begin by stating unequivocally that, counter to the protestations of some "experts," competition in the IT industry is alive and well. One demonstrable example is amount of capital investment by Venture Capitalists (VCs) and where that money is headed. Despite the recent downturn, VCs are still looking for the next "billion dollar deal." I know because I have worked with many of them. I won't get into the negative impact this "homerun or nothing" strategy has had on our industry but suffice it to say, billion dollar deals do not come from investing in mature markets with limited growth potential and large existing players. Billion dollar deals only come from investing in new markets with unlimited growth potential and those do not include office productivity software market or even the general PC software market. Indeed, a recent survey of VC's conducted by the DEMOletter, showed that nearly a third of those surveyed will invest over $100 million in start-ups in 2002 and that nearly 20 per cent are planning to invest up to $250 million. The sectors of the IT industry receiving this money include software and digital media. These are precisely the sectors that would benefit from this settlement. Suggestions that opposing the settlement would encourage VC's to change their stripes are ridiculous.

In fact, the information technology world is experiencing a shift away from desktop computing and toward other devices such as personal digital assistants (PDA's), cell phones, set top boxes/ game consoles, web terminals and powerful servers that connect them all. In all these growth markets, competition is very strong even though Microsoft is present. As of the third quarter of this year, more than 52 percent of all PDA's were shipped with the Palm operating system while only 18 percent carried a Microsoft operating system according to Gartner. With cell phone manufacturers rushing to integrate PDA functionality, there is are several large players including Symbian (a joint venture between Nokia, Motorola, Ericsson, Matsushita [Panasonic], and Psion), Palm, Linux and Research in Motion's Blackberry operating system. In the game console/ set-top box arenas, Microsoft is just entering the picture with established companies like Sony and Nintendo standing on large installed user bases.

The server market is probably the best example of this growing competition. According to IDC, Linux's worldwide market share of new and upgraded operating systems for servers was 27 percent in 2000. It was second only to Microsoft, which stood at 42 percent. IDC predicts predicted Linux's market share will expand to 41 percent by 2005, while Microsoft's will only grow to 46 percent. Things should only become more competitive with IBM putting a billion dollars into its Linux push this year. The vigorous competition in this space proves in the absence of government intervention, companies like Linux can thrive.

BENEFITS OF THE SETTLEMENT

As the members of the Committee are doubtlessly aware, on November 2, 2001 the DOJ and Microsoft tentatively agreed on a settlement (or consent decree) designed to end the federal antitrust suit. Soon thereafter, nine states attorneys general signed off on a revised settlement. The proposed settlement succeeds in striking a difficult compromise between the "drastically altered" finding of liability adopted by the Court of Appeals and the wishes of Microsoft competitors and critics for crippling sanctions against the company. Remarkably, the negotiators have worked out a settlement proposal that, while entirely satisfying to none, includes something for everyone.

A number of Microsoft competitors and their advocates have suggested that this agreement is flawed in that it "does not prevent Microsoft from leveraging its monopoly into other markets." This argument is based on an unfounded fear that Microsoft will attempt to monopolize other markets such as instant messaging and digital media. Undermining this argument is the fact that the Court of Appeals found unanimously that Microsoft did not use its monopoly in the browser (or middleware) market. The bottom line is that the settlement was focused on addressing the allegedly anticompetitive conduct of the past and preventing similar conduct in the future. It is entirely consistent with the basic tenet of antitrust law, which is to protect consumers and competition, not competitors.

With that understanding, it is important to address the benefits the industry and consumer will derive from implementation of the proposed settlement. ACT believes that the benefits of the settlement can be classified as follows:
1. Increased flexibility for Original Equipment Manufacturers (OEMs)
2. Increased flexibility for third party IT companies
3. Greater consumer choice
4. Effective enforcement

I will discuss each benefit in turn, paying particular attention to the positive effects on competition in our industry.

1. Increased flexibility for Original Equipment Manufacturers (OEMs)

OEMs play a pivotal role in "supply chain" of delivering a rich computing experience for consumers. They provide independent software vendors (ISVs), many of whom are small IT companies, a valuable conduit by which to sell their wares directly to consumers by vying for space on the computer desktop. Thus, it is critical that OEMs have the flexibility to meet market demands by negotiating with ISVs for this type of placement. This practice is known as "monetizing the desktop" and is consistent with market-based competition. Under the proposed settlement, OEMs will have the flexibility to develop, distribute, use, sell, or license any software that competes with Windows or Microsoft "middleware " without restrictions or any kind of retaliation from Microsoft. Reinforcing this flexibility, the settlement prohibits Microsoft from even entering into agreements that obligate OEMs to any exclusive or fixed-percentage arrangements. This allows OEMs to negotiate with an array of ISVs through the use of any number of incentives. Moreover, OEMs obtain some control over the desktop space for such things as icons and shortcuts. Another critical element allowing the OEMs to create a competitive playing field is that they have the ability to have non-Microsoft operating systems

(e.g., Linux) and other Internet Access Providers (IAP) offerings (e.g., alternative Internet connections such as AOL) launch at boot-up.

2. Increased flexibility for third party IT companies

Like OEMs, ISVs and Independent Hardware Vendors (IHVs) gain the flexibility to develop, distribute, use, sell, or license any software that competes with Windows or Microsoft middleware without restrictions or any kind of retaliation from Microsoft. The importance of this fact cannot be overstated. ISVs and IHVs, especially the thousands of small and mid-size companies in these categories, make up a bulk of the IT industry and will be able to utilize this flexibility to innovate and deliver "consumer critical" products such as instant messaging and digital media to consumers.

The ISVs and IHVs will obtain advance disclosure of Windows APIs, communications protocols, which will increase the quantity and quality of competitive product offerings. As with OEMs, Microsoft will be barred from thwarting competition by entering into agreements that obligate ISVs, IHVs, IAPs, or ICPs to any exclusive or fixed-percentage arrangements. It should be noted that the settlement restricts some freedoms in crafting contracts with Microsoft, and thus may discourage some companies that might otherwise like to sign on to "dance" with Microsoft. However, it also protects other companies from any efforts by Microsoft to prevent them from teaming up with Microsoft's competitors like Sun Microsystems or AOL.

3. Greater consumer choice

Nothing is as important to our industry as giving consumers, or end users, the freedom to choose what products and services they want or need. To this end, the settlement ensures that consumers will have the ability to enable or remove access to Microsoft or non-Microsoft middleware, or substitute a non-Microsoft middleware product for a Microsoft middleware product. Microsoft's detractors have generated much commotion with the notion that removal of icons or "automatic invocations" is not enough, and that to give consumers "real" choice, underlying code would have to be removed. This is nonsensical for two reasons. First, it is a known fact that removal of visible access (e.g., an icon) to middleware or an application is a very effective means of getting the end user to forget about it. Think about how many icons reside on the average user's desktop that serve to "remind" him of what product to use for a certain task. It is a simple case of "out of sight, out of mind." Second, it is also a known fact that removal of the underlying does nothing to enhance consumer choice, and actually could destabilize the platform, increasing costs to consumer software developers who could no longer count on programming interfaces within the Windows operating system. The net result of these provisions is that consumers will be in the position to pick the products they consider to best meet their needs - whether it be downloading music, sharing pictures over the Web, or chatting with friends via instant messaging applications.

Another myth propagated by Microsoft's competitors is that Microsoft gets to reset the desktop to its preferred configuration 14 days after the consumer buys it no matter what steps the OEM or the consumer have actually taken to try to exercise the choice to use a non-Microsoft product. This is absolutely false. The desktop would not be reset and consumers will always retain choice. For example, consumers can choose among the OEM's configuration, their own configuration and Microsoft's configuration.

4. Effective Enforcement

The final element of the settlement that will ensure competition is the enforcement provisions. Microsoft must license its intellectual property to the extent necessary for OEMs and other IT companies to exercise any of the flexibility provided in the agreement. In an unprecedented move, the decree creates a jointly appointed Technical Committee (TC) to monitor compliance. The TC will have three members and unspecified staff, and be granted unfettered access to Microsoft staff and documents. While the TC is a better enforcement mechanism than having to apply to a court for each software design element, it is not without some flaws. For example, there are no restrictions on how the TC can be utilized as a tool by Microsoft's competitors to delay shipment of an operating system or middleware product. While this may cause Microsoft some heartburn if it is used for such delay, it will be a fatal malady to the thousands of small and mid-size ISVs, IHVs, training firms and consultants that depend on a timely product launch. I am not a lawyer, so I can only propose a practical solution to this problem. Perhaps the competitors (or anyone else with the view that Microsoft is not complying with the consent decree) should be required to bring their problems to the TC at specified times during the development life cycle. This would prevent "last minute" delays.

Finally, Microsoft is required to implement an internal Compliance Officer to be responsible for handling complaints and compliance issues. This is yet another safeguard that aggrieved parties can use to ensure Microsoft's compliance with the consent decree.

Unfortunately these provisions are not enough to satiate some bent on seeing that this settlement never gets approved. For example, they question why the settlement lasts for only 5 years rather than the customary 10. This inquiry fails to acknowledge the realities of the IT industry and the speed at which we innovate. One need only think about the number and types of products that have emerged since 1998 to see why applying static conduct restrictions are out of step with our industry and provide no added value. Further, I believe seeking extended application of the settlement only exposes a bias against Microsoft

Because of the significant impact on our industry, I must also address the additional remedies proposed by the nine state attorneys general who did not sign the consent decree. While their aim to "restore competition" is a valid and important antitrust principle - as long as it is limited to the elimination of competitive barriers - their proposal ignores the Court of Appeals ruling and runs counter to established antitrust jurisprudence. The DOJ settlement agreement was wise to avoid the dangerous temptation to redesign and regulate market outcomes. I'll point out two defects of the state's proposal. First, requiring that Windows "must carry" Java does nothing for consumers who can download it with one click and only serves to thwart competition by giving Sun Microsystems a special government-mandated monopoly with which other middleware companies will have to compete. While I believe "must-carry" provisions are inherently anticompetitive, if the attorneys general were really trying to stand on principle they would have to ask for the same provisions for other middleware providers as well. Second, requiring Microsoft to port its Office product to Linux is tantamount to making it a "ward of the state." There are already several office productivity suites available to users of Linux and some are even free. It would stand to reason that if attorneys general are actually interested in removing any "applications barrier to entry" that may exist, they should force the developers of ALL popular

software products to port them to Linux. It is clear that from the extreme nature of these proposals that the settlement must encompass all reasonable mechanisms to restore competition. The respondents to the Voter Consumer Research polls mentioned above also question the need for the far-reaching remedies that would hamper Microsoft's ability to innovate. In Utah for example, nearly 70% of voters believe that Microsoft's products have helped consumers and over 80% of these voters feel that that Microsoft has benefited the computer industry. These numbers beg the question: Where's the harm that would justify the nine state's harsh remedies.

Conclusion

For ACT member companies, the IT industry and for me, it has been a very long three and a half years. This settlement reflects a balanced resolution to this litigation and a welcome end to the uncertainty that has hung over our industry at a time when certainty is what we need most. It addresses the anticompetitive actions articulated by a unanimous Court of Appeals. I believe Assistant Attorney Charles James when he said "This settlement . . . has the advantages of immediacy and certainty." It my sincere hope that the District Court will approve the settlement at the conclusion of the public comment period. There is no doubt in my mind that it is in the public interest to do so.

Again, I thank the Committee for the opportunity to include the views of ACT's member companies at this important hearing.