

Testimony of
The Honorable Charles A. James

December 12, 2001

Mr. Chairman and members of the Subcommittee, I am pleased to appear before you today to discuss the Department's still-pending antitrust enforcement action against Microsoft Corporation.

On November 2, 2001, the Department stipulated to entry of a proposed consent decree that would resolve the case. Nine states joined in the proposed settlement. We are in the midst of the 60-day public comment period under the Tunney Act, after which we will file a response to the comments, and the district court will rule on whether the proposed consent decree is in the public interest. Nine other states, and the District of Columbia, have not signed the proposed consent decree.

The Department's position regarding the proposed settlement is set forth in documents filed in the pending Tunney Act proceeding. Because of the pendency of the proceeding, and the somewhat remote possibility that the case will return to litigation, I am somewhat limited in what I can say about the case and settlement. Nonetheless, I am happy to appear before you today to discuss in general terms how the settlement promotes the public interest by resolving the allegations sustained by the court of appeals.

When we in the Department address the Microsoft case, it is important for us to ignore the media spectacle and clash-of-the-titans imagery and focus instead on the actual legal dispute presented to the court. In discussing the case and the proposed consent decree, it is important to keep in mind not only what the Department alleged in our complaint, but how the courts -- in particular, the D.C. Circuit -- ruled. As a result of the appeals court's ruling, the case is in many important respects considerably narrower than the one the Department originally brought in the spring of 1998 and narrower still than Judge Jackson's ruling in June of 2000.

I would like to take a few minutes to refocus attention on the legal allegations charged in the complaint, how those allegations were resolved in the courts, and the remedies in the proposed consent decree presently undergoing Tunney Act review. I believe these proposed remedies fully and demonstrably resolve the monopoly maintenance finding that the D.C. Circuit affirmed. The complaints filed by the Department, the states, and the District of Columbia alleged: (1) that Microsoft had engaged in a series of specific anticompetitive acts, and a course of anticompetitive conduct, to maintain its monopoly position in the market for operating systems designed to run on Intel-compatible personal computers, in violation of Section 2 of the Sherman Act; (2) that Microsoft had attempted to monopolize the web browser market, also in violation of Section 2; (3) that Microsoft had illegally tied its web browser, Internet Explorer, to its operating system, in violation of Section 1; and (4) that Microsoft had entered into exclusive dealing arrangements that also violated Section 1. A separate monopoly leveraging claim advanced by the state plaintiffs was dismissed prior to trial. After a full trial on the merits, the district court ultimately sustained the first three claims, while finding that the exclusive dealing claim had not been proved.

The D.C. Circuit, however, significantly narrowed the case, affirming the district court's finding of liability only as to the monopoly maintenance claim, and even there only as to a smaller

number of specified anticompetitive actions. Of the twenty anticompetitive acts the court of appeals reviewed, it reversed with respect to eight of the acts that the district court had sustained as elements of the monopoly maintenance claim. Additionally, the D.C. Circuit reversed the lower court's finding that Microsoft's course of conduct separately violated Section 2 of the Sherman Act. It reversed the district court's rulings on the attempted monopolization and tying claims, remanding the tying claim for further proceedings under a much more difficult rule of reason standard. And, of course, it vacated the district court's final judgment that had set forth the break-up remedy and interim conduct remedies.

The antitrust laws do not prohibit a firm from having a monopoly, but only from illegally acquiring or maintaining a monopoly through interference with the competitive efforts of rivals. There has never been any serious contention that Microsoft acquired its operating system monopoly through unlawful means, and the existence of the operating system monopoly itself was not challenged in this case.

With regard to the monopoly maintenance claim, the court of appeals upheld the conclusion that Microsoft had engaged in unlawful exclusionary conduct by using contractual provisions to prohibit computer manufacturers from supporting competing middleware products on Microsoft's operating system; by prohibiting consumers and computer manufacturers from removing Microsoft's middleware products from the desktop; and by reaching agreements with software developers and third parties to exclude or disadvantage competing middleware products -- all to protect Microsoft's monopoly in the operating system market.

The Department proved that Microsoft had engaged in these anticompetitive practices to discourage the development and deployment of rival web browsers and Java technologies, in an effort to prevent them from becoming middleware threats to its operating system monopoly. Netscape had gained a respectable market share as a technology for navigating the then-burgeoning Internet, and Netscape proponents were touting the prospect of a new world of Internet computing that would make operating systems less relevant. Netscape touted its web browser as a new category of software that came to be known as "middleware," a form of software that, like Microsoft's Windows operating system, exposed a broad range of applications program interfaces ("APIs") to which software developers could write applications. This created the potential that -- if Netscape Navigator continued to gain market share and could run on operating systems other than Microsoft's, and if large numbers of software developers wrote applications programs to it -- computer users would have viable competitive alternatives to Microsoft.

The middleware threat was nascent. That is, as both the district court and the court of appeals acknowledged, it was a potential threat to the operating system monopoly that had not yet become real. It could not be predicted when, if ever, enough applications programs would be written to middleware products for middleware to significantly displace Microsoft operating systems. Microsoft took this nascent middleware threat to its operating system monopoly seriously. The trial record disclosed a corporate preoccupation with thwarting Netscape and displacing Netscape's Navigator with Microsoft's Internet Explorer as the prevailing web browser. This campaign featured a host of strong-arm tactics aimed at various computer manufacturers, Internet access providers, and independent software developers. Even the decision to integrate its own browser into the operating system -- in effect, giving it away for free -- had an element of impeding the growth of Netscape and once was described as taking away Netscape's oxygen. Microsoft took similar actions against Java technologies. Among other things, Microsoft required software developers to promote its own version of Java technology

exclusively and threatened developers if they assisted competing Java products.

The district court ruled not only that Microsoft had engaged in various specified illegal exclusionary practices, but that these acts were part of an overall anticompetitive course of conduct. The D.C. Circuit agreed as to some of the specified practices, while ruling that others -- for example, Microsoft's practice of preventing computer manufacturers from substituting their own user interfaces over the Windows interface supplied by Microsoft -- were justified and thus lawful. The D.C. Circuit also rejected the course-of-conduct theory, under which Microsoft's specific practices could be viewed as parts of a broader, more general monopolistic scheme, ruling that Microsoft's practices must be viewed individually.

Following the appellate court's instructions, we, in considering a possible remedy, focused on the specific practices that the court had ruled unlawful. We took as a starting point the district court's interim conduct remedies. Those remedies, however, were based on a much wider range of liability findings than had been affirmed on appeal. Accordingly, they had to be tailored to the findings that had actually been affirmed. Further, because the interim conduct remedies were designed to apply only as a stop-gap until the district court's divestiture order was implemented, we broadened them in important respects to more fully address the remedial objectives of arresting the anticompetitive conduct, preventing its recurrence, and restoring lost competition to the marketplace. Finally, we updated the remedies to strengthen their long-term effectiveness in the face of the rapid technological innovation that continues to characterize the computer industry -- so that they will be relevant in the Windows XP operating system world and beyond. Under the proposed consent decree, Microsoft will be required to disclose to other software developers the interfaces used by Microsoft's middleware to interoperate with the operating system, enabling other software developers to create competing products that emulate Microsoft's integrated functions. Microsoft will also have to disclose the protocols that are necessary for software located in a server computer to interoperate with Windows on a PC. Microsoft will have to permit computer manufacturers and consumers to substitute competing middleware software on the desktop. It will be prohibited from retaliating against computer manufacturers or software developers for supporting or developing certain competing software. To further guard against possible retaliation, Microsoft will be required to license its operating system to key computer manufacturers on uniform terms for five years.

Microsoft will be prohibited from entering into agreements requiring the exclusive support or development of certain Microsoft software, so that software developers and computer manufacturers can continue to do business with Microsoft while also supporting and developing rival middleware products. And Microsoft will be required to license any intellectual property to computer manufacturers and software developers necessary for them to exercise their rights under the proposed decree, including, for example, using the middleware protocols disclosed by Microsoft to interoperate with the operating system.

Any assumption that, had we litigated the remedy, we were certain to have secured all of this relief and possibly more misses the mark. The middleware definition, for example, was a very complex issue and would have been hard fought in a litigated remedy proceeding. The term had no generally accepted industry or technical meaning. At the time of trial, the term was used to describe software programs that exposed APIs. But in today's world, by virtue of the extensive degree to which software programs interact with each other, a very broad range of programs -- large and small, simple and complex -- expose APIs. At the same time, middleware had to be defined more broadly than the browser, or it would not provide sufficient protection for the potential sources of competition that might emerge. So we developed a definition of middleware,

designed to encompass all technologies that have the potential to be middleware threats to Microsoft's operating system monopoly. It captures, in today's market, Internet browsers, e-mail client software, networked audio/video client software, and instant messaging software. On a going-forward basis, it also provides guidelines for what types of software will be considered middleware for purposes of the decree in the future. These guidelines are critical because, while it is important that future middleware products be captured by the proposed decree, those products will not necessarily be readily identified as such.

The proposed decree protects competition in the middleware market through a variety of affirmative duties and prohibitions, which I listed a minute ago. By requiring disclosure of a broad range of interfaces and protocols that will secure interoperability for rival software and servers, broadly banning exclusive dealing, giving computer manufacturers and consumers extensive control of the desktop and initial boot sequence, and prohibiting a broad range of retaliatory conduct, the proposed decree will require Microsoft to fundamentally change the way in which it deals with computer manufacturers, Internet access providers, software developers, and others. These prohibitions had to be devised keeping in mind that Microsoft will continue for the foreseeable future to have a monopoly in the operating systems market. While we recognized that not all forms of collaboration between Microsoft and others in the industry are anticompetitive, and that some actually benefit competition, we drafted the non-discrimination and non-retaliation provisions broadly enough to prevent Microsoft from using its monopoly power to apply anticompetitive pressure in this fashion.

We concluded, particularly in light of intervening technological developments in the computer industry, that the remedial objective of restoring lost competition had to mean something different than attempting to restore Netscape and Java specifically to their previous status as potential nascent threats to Microsoft's monopoly. Attempting to turn back the hands of time would likely prove futile and would risk sacrificing important innovations that have moved the industry beyond that point. So we focused instead on the market as it exists today, and where it appears to be heading over the next few years, and devised a remedy to recreate the potential for the emergence of competitive alternatives to Microsoft's operating system monopoly through middleware innovations. With a reported 70,000-odd applications currently designed to run on Windows, the applications barrier to entry is quite formidable. The most effective avenue for restoring the competitive potential of middleware, we concluded, was to ensure that middleware developers had access to the technical information necessary to create middleware programs that could compete with Microsoft in a meaningful way -- that is, by requiring Microsoft to disclose the APIs needed to enable competing middleware developers to create middleware that matches Microsoft's in efficiency and functionality.

API disclosure had apparently been a very difficult obstacle to resolution of the case at every stage. There had never been any allegation in the case that Windows was an essential facility, the proprietary technology for which had to be openly shared in the industry. So we are very pleased that we were able to secure this crucial provision in the proposed decree.

Similarly, the proposed decree goes beyond the district court's order in requiring Microsoft to disclose communications protocols for servers if they are embedded in the operating system, thereby protecting the potential for server-based applications to emerge as a competitive alternative to Microsoft's operating systems monopoly. Although the issue of Microsoft's potential use of its monopoly power to inhibit server-based competition was barely raised and never litigated in the district court, we believed it was an important concern to resolve in the final negotiations. The proposed decree also requires Microsoft to create and preserve "default"

settings, such that certain of Microsoft's integrated middleware functions will not be able to override the selection of a third-party middleware product, and requires Microsoft to create add/delete functionality to make it easier for computer manufacturers and users to replace Microsoft middleware functionality with independently developed middleware. These are other important respects in which, in light of intervening technological changes, the proposed decree goes beyond the relief contemplated in the district court's interim relief order. By giving middleware developers the means of creating fully competitive products, requiring the creation of add/delete functionality, and making it absolutely clear that computer manufacturers can, in fact, replace Microsoft middleware on the desktop, the decree will do as much as possible to restore the nascent threat to the operating system monopoly that browsers once represented.

The proposed decree contains some of the most stringent enforcement provisions ever contained in any modern consent decree. In addition to the ordinary prosecutorial access powers, backed up by civil and criminal contempt authority, this decree has two other aggressive features. First, it requires a full-time, on-site compliance team -- complete with its own staff and the power to hire consultants -- that will monitor compliance with the decree, report violations to the Department, and attempt to resolve technical disputes under the disclosure provisions. The compliance team will have complete access to Microsoft's source code, records, facilities, and personnel. Its dispute resolution responsibilities reflect the recognition that the market will benefit from rapid, consensual resolution of issues whenever possible, more so than litigation under the Department's contempt powers. The dispute resolution process complements, but does not supplant, ordinary methods of enforcement. Complainants may bring their inquiries directly to the Department if they choose.

The decree will be in effect for five years. It also contains a provision under which the term may be extended by up to two additional years in the event that the court finds that Microsoft has engaged in repeated violations. Assuming that Microsoft will want to get out from under the decree's affirmative obligations and restrictions as soon as possible, the prospect that it might face an extension of the decree should provide an extra incentive to comply.

Our practice with regard to enforcement is never influenced by the extent to which we "trust" a defendant. Rather, a decree must stand on its own as an enforcement vehicle to ensure effective relief and must contain enforcement provisions sufficient to address its inherent compliance issues. In this case, those compliance issues are complex, as the decree seeks to address Microsoft's interactions with firms throughout the computer industry. Under the circumstances, I believe the extraordinary nature of the decree is warranted.

Some have criticized the decree for not going far enough. Some have asked why we did not continue to pursue divestiture as a possible remedy. We had several reasons. First, the court of appeals made it clear that it viewed the break-up remedy with skepticism, to put it mildly. The court ruled that on remand the district court must consider whether Microsoft is a unitary company -- i.e., one that could not easily be broken up -- and whether plaintiffs established a significant causal connection between Microsoft's anticompetitive conduct and its dominant position in the market for operating systems -- a finding not reached by the prior judge. Second, the legal basis for the structural separation the Department had been seeking was undercut by the failure to sustain the two claims that had challenged Microsoft's right to compete outside its operating system monopoly by integrating new functions into Windows, the attempted monopolization claim and the tying claim. The former was dismissed, and the latter was remanded under a much more difficult rule-of-reason standard. The court of appeals ruled that, albeit with some limits, Microsoft could lawfully integrate new functions into the operating

system and use the advantages flowing from its knowledge and design of the operating system to compete in downstream markets.

Third, and more generally, the relief in a section 2 case must have its foundation in the offending conduct. The monopoly maintenance finding, as modified by the court of appeals, and without the "course-of-conduct" theory, would not in our view sustain a broad-ranging structural remedy that went beyond what was necessary to address Microsoft's unlawful responses to the middleware threat to its operating system monopoly. Indeed, our new district judge, Judge Kollar-Kotelly, stated in open court that she expected our proposed remedy to reflect the fact that portions of our case had not been sustained.

Finally, from a practical standpoint, even assuming that we could have eventually secured a breakup of Microsoft -- a very dubious assumption in light of what the court of appeals and Judge Kollar-Kotelly have stated -- the time it would have taken to continue litigating the breakup and the inevitable appeals could easily have delayed relief for another several years. By taking structural relief off of the table at the outset of the remedy proceeding on remand, we were able to get favorable procedural rulings that were essential to moving quickly to a prompt resolution.

More generally, a number of critics have suggested ways in which we could have further constrained Microsoft's conduct in the marketplace -- either by excluding it from markets outside the operating system market, restricting it from integrating functions into its products or collaborating with others, or requiring it to widely share its source code as an open platform. While it is certainly true that restrictions and requirements of this sort might be desirable and advantageous to Microsoft's competitors, they would not necessarily be in the interest of competition and consumers overall; many would reduce consumer choice rather than increase it. Moreover, to the extent these restrictions go beyond what is needed to remedy proven antitrust violations, they are not legitimate remedial goals. The objectives of civil antitrust enforcement are remedial, and they focus on protecting and restoring competition for the benefit of consumers, not on favoring particular competitors.

As to more complex questions regarding whether the decree has properly covered all the elements that will be needed for full relief, questions of that nature are entirely appropriate and hopefully will be raised and addressed in the Tunney Act process.

But I believe the decree, by creating the opportunity for independent software vendors to develop competitive middleware products on a function-by-function basis, by giving computer manufacturers the flexibility to place competing middleware products on Microsoft's operating system, and by preventing retaliation by Microsoft against those who choose to develop or use competing middleware products, fully addresses the legitimate public goals of stopping Microsoft's unlawful conduct and restoring competition lost on its account.

Mr. Chairman, a vigorously competitive computer software industry is vital to our economy, and the Department is committed to ensuring that it remains competitive. I hope that my testimony has helped members of the Committee more fully understand why the Department is completely satisfied that the proposed consent decree now before the district court will provide a sufficient and effective remedy for the anticompetitive conduct in which Microsoft has been found to have engaged in violation of the Sherman Act. I would be happy to answer any questions you or other members of the Committee may have.