Prepared Remarks

REMEDIES IN HIGH-TECH INDUSTRIES
FTC/DOJ Section 2 Hearings
March 28, 2007

David A. Heiner
Vice-President and Deputy General Counsel
Microsoft Corporation

This is a subject upon which Microsoft has, to put it mildly, quite a bit of experience. I thought it might be helpful, at the outset, to briefly recap the remedies to which Microsoft has been subject over the past decade or so. [Slide 2]

In 1994, a consent decree and nearly identical European Union undertaking were put in place. These were mostly contractual in nature. In 2002, a consent decree and associated litigated final judgment were entered in the Section 2 case against Microsoft. The section 2 case was followed by a number of competitor lawsuits. Hundreds of consumer class actions were filed. Nearly all of these private lawsuits have been settled, with payments and conduct relief.

In March 2004 the European Commission issued its decision against Microsoft. The Commission took a different approach to the issues than did the U.S. court in the Section 2 case. In February 2006, the Korea Fair Trade Commission issued its decision against Microsoft. The KFTC took yet a third approach. The EC and KFTC decisions are on appeal.

As you might imagine, all of this generates quite a bit of work within Microsoft and its law department. When I joined Microsoft in 1994 I was the first full-time antitrust lawyer at the company. Today I lead a group of about 30 professionals, dedicated full time to antitrust

counseling and compliance with remedies. This group includes software developers and business people, as well as lawyers and paralegals. All told, a few hundred people at Microsoft have been engaged in compliance work over the past few years. [Slide 3]

I'd like to begin with a comment on the overall approach to fashioning relief. I would suggest that it is probably better to focus on creating or preserving opportunities for competitors, rather than limiting the defendant's efforts to deliver consumer value. This is the approach taken by the U.S. consent decree. The Court of Appeals had reversed and remanded the Section 1 tying claim against Microsoft, but affirmed Section 2 liability relating to the manner in which Internet Explorer had been integrated into Windows 98. The decree that resulted did not require that any functionality be removed from Windows. Rather, every provision of the decree is directed at creating or preserving opportunities for competitors, both as a matter of product design and contractually. The focus is upon ensuring that distribution channels remain open. This approach was strongly approved by the Court of Appeals in the Section 2 case. Today new Windows PCs come loaded up with software from Microsoft's competitors, such as Google, Yahoo, AOL, Symantec, McAfee and many others. Under this approach, consumers benefit from the ability to choose either integrated solutions or separate programs that run well on Windows, or—as is so often the case—both.

The European Commission has taken a different approach. The Commission ordered Microsoft to create new versions of Windows from which media playback software has been removed. These are called Windows XP N and Windows Vista N. They were built following extensive compliance discussions with the Commission. They are available in every European language. However, not a single PC manufacturer has chosen to license them. These operating

systems sit on the shelf. Costs have been imposed, but there is little apparent benefit for anyone. I will return to another aspect of this in a moment. For now I would note only that the U.S. approach seems far more effective at advancing antitrust values.

This focus on creating opportunity tells us something about the proper objective of antitrust remedies. [Slide 4] I would suggest that remedies should be put in place in order to safeguard competitive opportunities, but not necessarily to engineer any particular market outcome, such as a reduction in market share. This is for the market to determine, once any competitive restraints have been removed.

Indeed, even if engineering market outcomes were thought to be desirable in theory, it is hard to see how this could be accomplished in practice in most cases. By its nature, a remedy will only govern the conduct of the defendant, not other market participants. Everyone else – competitors, developers of complementary products, and, most notably, consumers – will act according to self-interest. This is particularly noteworthy in high-tech markets where products often interconnect with one another in complex ways.

For example, both the US and EU remedies require Microsoft to make available certain technology, called communications protocols, for use by competitors in their products. About 30 firms have taken licenses to this technology under the U.S. program and one to date under the similar European program. Whether firms choose to take a license, and what kinds of products they build with these licenses, is of course entirely up to them and outside the control of either Microsoft or any antitrust agency.

This general point is relevant outside the context of access remedies. Internet Explorer continues to have high, although declining, browser share. Should this be seen as a shortcoming of the consent decree? Well, the open source Firefox Web browser has about 14% share, up from zero just a few years ago. Given the safeguards set up by the consent decree, which apply on a worldwide basis, there is no reason Firefox couldn't have much higher share, if that reflected consumer preferences. Indeed, Firefox share is about 33% in Germany and Poland, up from 20% just last year.

This focus on competitive opportunity rather than outcome is especially important in government actions. As the Court of Appeals explained in the *Microsoft* case, liability can be established with little or no proof of actual market impact—what the Court termed a "rather edentulous test for causation." *United States* v. *Microsoft Corp*., 253 F.3d 34, 79 (D.C. Cir. 2001). Indeed, the district court found that that there was no proof that the success of Internet Explorer was due to unlawful conduct. *New York* v. *Microsoft*, 224 F. Supp. 2d 76, 185 n. 81 (D.D.C. 2002). Where there is no proof of market impact in the first place, it would seem especially inappropriate to expect a remedy to bring about a particular market outcome.

This brings me to my third observation. [Slide 5] Whatever the proper role of antitrust remedies may be in the abstract, it is important that that they be fully thought through before liability proceedings are commenced. This is true for at least two reasons. First, and most importantly, if it is hard to devise an appropriate remedy, that may suggest that there is no liability in the first place. At the very least, it may suggest that the liability rules were not sufficiently clear to provide any real notice to the defendant of what would be deemed

unlawful later. Second, absent a clear view on the question of remedy, it may be difficult or impossible to attain rapid relief through settlement.

These points are well-illustrated, I think, by Microsoft's experience in dealing with the Windows integration issues. The addition of new functionality to Windows can present competitive challenges for firms that wish to offer comparable functionality separately. Antitrust agencies around the world have focused on that. At the same time – and as the Court of Appeals noted in the *Microsoft* case – such integration can lead to important benefits for software developers, the PC industry generally and consumers. This is why functionality has been integrated into new computer operating systems for more than 20 years, and why integration of functions is common across many product categories. How should these competing considerations be addressed?

In the U.S., the consent decree approach I outlined earlier is now in place. But there were quite a few bumps in the road along the way, including at least three rounds of failed settlement talks, one of which was conducted by Judge Posner in Chicago. At least part of the reason that these talks failed was disagreement among the Department of Justice and various of the 20 States as to what forms of relief would be suitable. Absent a clear view on this, no agreement could be reached and the eventual remedy was delayed.

The history in Brussels is instructive as well. In early 2004, Microsoft proposed a variety of remedies to address the Commission's concerns regarding the inclusion of media functionality in Windows. The Commission case team devoted a great deal of time to fully defining and exploring these proposals, and Microsoft is grateful for that. Ultimately, however, the Commission determined that a general remedy should be devised that would address all

future tying cases. Given the range of possible fact patterns and the benefits of integration, however, neither the Commission nor Microsoft was able to articulate any such remedy to govern future product design, despite prodigious efforts by both sides. As a result, settlement talks failed.

The Commission proceeded to impose the logical remedy for a tying case: an order to un-tie. As a result, PC manufacturers and consumers can now choose to get Windows with or without its media playback functionality. They have chosen the full-featured version of Windows, as might be expected. Should it be unlawful for a firm to fail to create a product for which there is no consumer demand? Here consideration of remedy may suggest that there was no unlawful tie in the first place. The same might be said about the package discounting in *LePages* or the selective discounting and output expansion in *American Airlines.*

I would like to conclude with two final observations of a practical nature. [Slide 6] First, in Microsoft's experience, it would seem that the legal process is generally best suited to contractual remedies. Particular cases may call for other forms of relief, but we should recognize that these will come with significant challenges for all concerned. Contracts are good because they are within the purview of lawyers. We can understand them well. They are relative easy to monitor—for the defendant and for the enforcers. Essentially no issue of note has arisen regarding Microsoft's compliance with the contractual provisions of the consent decree.

Product design remedies are more difficult. Here considerable technical expertise may be required in order to devise and subsequently monitor a remedy. Ultimately lawyers will remain responsible for making compliance judgments regarding highly technical matters, and

that may be difficult even with expert help. In addition, agency lawyers will inevitably find themselves drawn into details of product design and engineering trade-offs between various design choices. To deal with these kinds of complexities, the Technical Committee put in place under the U.S. decree, for instance, now has 40 full time employees.

Remedies that require sharing of complex technology are also quite challenging. Technological complexity can lead quickly to enforcement complexity. Protocol licensing, for example, is just one of eight major provisions in the U.S. decree, but takes up the lion's share of compliance work for Microsoft and the agencies. The EU protocol remedy introduces still greater complexity. That is because it seeks to enable fundamentally different computer operating systems, with different computer architectures, to work together as if they were one. This is a computer science project. Even the Commission recently explained that making this work would require a massive development effort by third parties, and that hasn't happened.

The result has been considerable frustration for the Commission and Microsoft. This past summer the Commission imposed a fine of € 280 million for failing to complete this project to the satisfaction of the Commission's technical advisor.

Pricing is another challenge, and likely will be for any access case involving information good such as software. The protocol technology that Microsoft has made available was developed by the company over more than ten years. It is covered by roughly 35 patents, with many more pending. It is covered by copyright and trade secret law. How is this to be valued? The answer is not entirely obvious given the many ways that software is monetized today and varying business models. Microsoft has suggested pricing that is comparable to the U.S. protocol program, where many firms have taken licenses. That pricing is backed up by more

than 1,000 pages of analysis prepared at the Commission's request. The Commission has taken issue with this pricing, however, and is threatening to impose new fines that could run to hundreds of millions of euros.

My final observation relates to globalization. [Slide 7.] From Microsoft's perspective (and that of other high-tech companies), it is increasingly important that antitrust agencies cooperate closely on remedies and show due respect for principles of international comity. For sound economic reasons, the Windows operating system is essentially identical all over the world. That uniformity is critical to the role Windows plays in fostering interoperability among thousands of compatible hardware and software products. And this is threatened today by the varying approaches to the tying issue that I referenced earlier. In the compulsory licensing area, as well, we see divergent approaches in the U.S. and other geographies. In the age of the Internet, once trade secrets are forcibly disclosed anywhere in the world, they can never be recovered. Absent greater deference to comity principles, we may well find that the legal regime that imposes the most onerous licensing obligations will prevail on a worldwide basis.