Lessons from the *Microsoft* Antitrust Cases

BY ANDREW I GAVIL AND HARRY FIRST

For three decades Microsoft has been engaged with the global system for enforcing competition policy. In an excerpt from their new book *The Microsoft Antitrust Cases*, the authors Andrew I. Gavil and Harry First examine the remedies put in place and the further lessons we can learn from these antitrust cases.

Perhaps the greatest challenge for any remedy is to restore the market to where it was before the conduct occurred or, perhaps more controversially, to jump-start competition in a market that has been damaged in order to improve incentives for more competition. The market can then be left to evolve, with competition not fettered by the offending conduct. From this perspective, we draw three lessons from the *Microsoft cases*. None of these observations counsel for "regulating" markets; rather, the lesson here is that true confidence in markets and their outcomes may suggest the need for restorative and rehabilitative measures after a period of anticompetitive distortion.

First, competition-enforcement agencies and courts should strive to preserve "competitive moments." If the wheels of antitrust enforcement moved too slowly in any dimension in the *Microsoft* cases, it was with respect to preserving rivalry before it was effectively vanquished. Timidity in the use of status-quo-preserving preliminary relief, such as temporary restraining orders and preliminary injunctions, can allow such moments to pass. And they cannot be easily recreated, especially if new competitors have been damaged beyond repair or have exited the market. The "balance of equities" should be struck in favor of protecting such emergent competition, especially when tipping is a genuine threat, the justifications for the dominant firm's conduct appear suspect, and the burden of preliminary relief on the dominant firm is relatively small.

The standard refrain to this view, often repeated by defendants in U.S. antitrust litigation, is that the antitrust laws are intended to "protect competition, not competitors"[1] Though this slogan may serve as a valuable guiding principle in competitive markets, it shouldn't be accepted uncritically when invoked by a self-interested dominant firm urging it as an immutable article of faith to immunize its conduct from antitrust scrutiny. As one court has correctly observed, "in a concentrated market with very high barriers to entry, competition will not exist without competitors."[2] The slogan assumes a false dichotomy. In the context of public enforcement, it also has been invoked in support of the criticism that agencies aren't able to differentiate valid claims of illegitimate exclusion from the whining of rivals facing legitimate though aggressive competition by their dominant competitors. Agencies, however, aren't so easily taken in. And in both the United States and Europe, there are courts to check any possible instances of such agency capture. Although courts certainly can be mistaken in their judgments, any continued insistence that the *Microsoft* cases were simple illustrations of government being captured by a dominant firm's competitors is unsupportable.

Second, markets function best when the ability of consumers to make informed choices about their competitive options is unimpaired. The interaction of supply and demand to produce efficient market outcomes assumes as much. This simple maxim is the foundation for consumer-protection laws that prohibit deception and fraud, and for many regulations that mandate disclosures of truthful information about product characteristics. It is also at the heart of antitrust regimes committed to protect consumers' welfare. As the U.S. Supreme Court has recognized, conduct that renders markets "unresponsive to consumer preference" is "not consistent with this fundamental goal of antitrust law."[3] When such conduct is found, remedies should be targeted at restoring the damaged mechanism.

In myriad ways, Microsoft sought to insulate its products from the test of the marketplace rather than subject them to competition on the merits. This was true of Microsoft's IE and WMP middleware, and it was true of Windows. The negotiated remedy in the United States did little to reestablish consumers (including OEMs [Original Equipment Manufacturers]) as

Markets function best when the ability of consumers to make informed choices about their competitive options is unimpaired. The interaction of supply and demand to produce efficient market outcomes assumes as much.

the drivers of demand beyond prohibiting some of Microsoft's most coercive design and contracting practices. In this respect, the solutions proposed and tried by the Korea Fair Trade Commission (KFTC) and later by the European Commission (EC) had some underappreciated aspects. Both the KFTC and the EC tried to restore the role of consumer-driven decision making in the market, and both tried to do so without unduly interfering with Microsoft's ability to offer its own products in competition with those of its rivals. Even if consumers continued to prefer Microsoft's products, this creative effort to reempower consumers was an important example for future cases involving similar conduct and similar consequences. The goal isn't a pre-determined quota for each rival, but a return to consumer - driven allocation of market share.

Nevertheless, as we have discussed, these efforts faced withering criticisms from some commentators and from U.S. antitrust authorities. Critics caricatured any remedy that required Microsoft to alter Windows as software engineering by amateurs, charging that courts and enforcement agencies were poorly equipped to design software - a task they said was best left, unfettered, to software firms like Microsoft. This was another exaggerated criticism heaped on an illusory issue. True, agencies and courts shouldn't pretend to be software designers. But they didn't have to be software designers in order to judge the results of a software firm's practices. The U.S. Department of Justice, the states, and Judge Jackson didn't have to be software engineers to understand that Microsoft had designed IE (Internet Explorer) to be irremovable or that the commingling of code meant that if IE were fully removed then Windows would be disabled. Likewise, the Korea Fair Trade Commission and the European Commission didn't have to undertake the design work to know whether the ballot-screen options they demanded provided simple mechanisms that consumers could use to express their preferences for competing products. Software design can be judged by its performance, and that can include whether its features facilitate, inhibit, or leave untouched competition on the merits.

Third, as we have already noted, no court can resuscitate a hobbled or vanquished competitor. When conduct is deemed anticompetitive because it fortifies or raises barriers to entry, effective remedies should include steps to dismantle the barriers and facilitate easier entry. Perhaps the most prominent example of this approach in the Microsoft cases was mandated disclosure of interoperability information, required under the U.S. consent decree even though, in contrast to the European cases, there were no claims of refusal to supply. The parties and courts in both jurisdictions readily understood that this was the most forward-looking of the remedies, because it would redirect competition from exploitation and elevation of barriers to entry toward competition on the merits of the product offerings of Microsoft and its rivals. In truth, however, again it isn't certain whether these measures were effective in realizing their stated goals.

The most dramatic remedial proposal - structural relief that would have reorganized the company into two parts - remained untried, and the record remained insufficient to allow its wisdom or its likely effectiveness to be judged. Markets are about incentives, and structural relief is more effective than court injunctions at altering incentives. It was thought that separating Microsoft's operating-system and applications businesses would diminish or eliminate impediments to entry and fortify incentives for competition in the markets for middleware and operating systems. Although the theory seemed sound, the proposal was largely an economist's construct. Microsoft had always been an integrated firm, so reorganizing it in the hope of altering its incentives was a gamble that could have had severe and hard - to predict consequences for the industry.

Did Antitrust Enforcement Dull Microsoft's Innovative Edge?

A final strand of narrative emerged as the *Microsoft* cases were coming to a close. Although some of its elements had long been a part of the story line that Microsoft had advocated, it

Latest Technology Innovations Introduced at the 2010 Consumer Electronics Show

added a distinct, "*post-Microsoft*" epilogue, and it raised a concern that will continue to confront antitrust enforcers in the technology sector: how best to analyze the strategies and counterstrategies associated with the emergence of disruptive technologies.

In this narrative, Microsoft is portrayed as an innovating dominant firm. Its rivals, unable or unwilling to keep pace with it, sought the protection of government antitrust enforcers, who, by seeking to impose liability on Microsoft for its innovations, are portrayed not only as inept and ill-informed, but as enemies of innovation. Beyond that, some critics of the cases have argued that antitrust enforcement hobbled Microsoft – that by inhibiting it from competing aggressively, antitrust enforcement dulled its overall capacity for innovation in the aftermath of the cases.

As was true of Microsoft's efforts to portray its conduct as innovative, the premise of this closing plot twist is inconsistent with the facts found in the various cases. Antitrust enforcement didn't hobble Microsoft; Microsoft got into antitrust trouble when it fell behind its rivals and tried to use its market power to exploit the characteristics of the industry to slow its rivals and buy time to catch up. As Bill Gates had acknowledged, Microsoft had been caught unprepared for the "Internet tidal wave." The same was true with respect to the development of server operating systems, as was found in the EC's case. When the "Internet tidal wave" hit, Microsoft lost its footing. Its emerging rivals, which had recognized the Internet's potential, began to design software to fully exploit it – first browsers, distributed programing language, and media players, and later search engines.

The cases against Microsoft, therefore, cannot fairly be viewed as misguided efforts to impose liability on a dominant but innovative firm. They were prompted not by any "innovative" product strategy, but rather by Microsoft's all-out counter-strategy to preserve its Windows monopoly by impeding competition from its more innovative rivals. If Microsoft was hobbled, it was hobbled by competition, by complacency of a kind long associated with monopolists, and by a lack of foresight – not by antitrust enforcement. It was caught flat on its feet when other firms brought new technological capabilities to the market.

The introduction of disruptive technologies will continue to generate tensions between new firms and incumbents, especially when the latter are dominant. As was true in the *Microsoft* cases, an important question for enforcers will be whether the dominant firm is the purveyor of the disruptive innovation (which might counsel for self-restraint) or whether its rivals are the purveyors. If this threshold issue can be evaluated correctly, government enforcement will be a valuable friend and supporter of innovation, not its enemy.

Conclusion

When Microsoft rose to prominence, in the 1980s, it was accompanied by IBM and Intel. Although they were influenced by the innovations of Xerox, Apple, and other companies, these three firms sat together at the center of the personal technology universe and apart from most other firms in terms of dominance. IBM had attracted the attention of antitrust enforcers long before the advent of the personal computer, and Intel would later be chastised by the Federal Trade Commission and by other companies (including its principal rival, Advanced Micro Devices) for seeking to maintain its position of dominance through anticompetitive means. Today, the center of the technology universe is a more complex place, occupied by a group of extraordinarily successful companies, each associated with a particular segment of the technology marketplace but all both interdependent and in competition to varying degrees. Microsoft and Intel remain, now accompanied by Apple, Amazon, Facebook, and Google.[4] Each of these companies has been a subject of scrutiny under antitrust and consumer-protection laws for various reasons and in various parts of the world. That scrutiny probably will continue, owing to some of the very same market characteristics that may have provided Microsoft with the incentives to fortify its monopoly position not

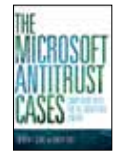
Antitrust enforcement didn't hobble Microsoft; Microsoft got into antitrust trouble when it fell behind its rivals and tried to use its market power to exploit the characteristics of the industry to slow its rivals and buy time to catch up.

through innovation and the superiority of its products but through the exercise of market power.

This is neither surprising nor historically unusual. To a significant degree, the cutting-edge industries of the day have always drawn the attention of antitrust enforcers. This was true of the railroads and of the steel, oil, and staple-product industries of the turn of the twentieth century, and it was true of the large grocery and retailing business of the mid twentieth century. Viewed in a larger historical context, therefore, technology industries aren't being singled out and "targeted" for any kind of "special" treatment. They have drawn attention to themselves because of their success and their prominence, and in some instances because of abusive practices intended to secure or maintain their prominence. Also, as was once true of the railroads and of the oil industry, the technology industry today is driving development and economic progress. Thus, the attention it is receiving is appropriate, so long as enforcement is properly directed at anticompetitive collusion and exclusion and is attentive to the need to preserve true efficiencies and incentives for innovation.

Today's developing industries sometimes combine breakthrough technologies and new capabilities with new methods of distribution and sale. The field of competition can be global. The products, the services, and the business models can be complex, dynamic, and exciting to study. The products can be used by millions if not billions of consumers. And the negative effects of anticompetitive conduct can include erecting or fortifying barriers to new and path-breaking competition. Some of the most promising and potentially game-changing technological developments today are outside of the highly visible world of consumer technology. Breakthroughs in industrial software and in new methods of manufacturing probably will transform the global economy in this still-new century. And more traditional industries – especially those now undergoing consolidation and transformation, such as transportation, telecommunication, and the various media-related industries, such as the music, book, and video content industries, should not be overlooked. As has always been true of competition policy, enforcement efforts must strive for balance. It would be a mistake to simply take a pass on technology, relying on platitudes like those served up during the *Microsoft* cases (for example, that a field is so fast moving or so dynamic that intervention can never be justified). Deterrence of egregious conduct must be maintained, and that can happen only with the credible threat of measured antitrust enforcement against demonstrably or predictably anticompetitive strategies. Competition-enforcement agencies will need the resources to remain educated about these changing industries and to maintain their capacity to bring the occasional, but essential, "big case."

More broadly, from the perspective of competition policy, the *Microsoft* cases teach that those who make competition-enforcement policy must continue to be attentive to the behavior of dominant firms. As one commentator has persuasively argued, exclusion is a "core competition concern" that should not be relegated to secondary status behind cartels.[5] We find no reason in the collective experience of Microsoft to doubt that proposition or to question whether the antitrust laws and institutions are capable of continuing to facilitate progress by protecting competition and the competitive process.



About the Authors

Andrew I Gavil is a Professor of Law at Howard University School of Law. He has taught courses on antitrust law, civil procedure, complex litigation , federal courts, and federal regulation since 1989. From September 2012 to December 2014 he served as the Director of the Office of Policy Planning at the US Federal Trade Commission.

Harry First is the Charles L. Denison Professor of Law at New York University School of Law and Co-Director of the law school's Competition, Innovation, and Information Law Program. From 1999-2001 he served as Chief of the Antitrust Bureau of the Office of the Attorney General of the State of New York. Professor First's teaching interests include antitrust, regulated industries, international and comparative antitrust, business crime, and innovation policy.

References

1. Phrase originates from the Supreme Court's 1962 *Brown Shoe* decision (*Brown Shoe Co. v. U.S.*, 370 U.S 294 (1962).
2. *Spirit Airlines, Inc. v. Northwest Airlines*, Inc., 431 F. 3d 917, 951 (6th Cir. 2005).
3. *NCAA v. Board of Regents of the University of Oklahoma*, 468 U.S. 85, 107 (1984).
4. See "Technology Giants at War: Another Game of Thrones," *The Economist*, Dec. 1, 2012.
5. Jonathan B. Baker, "Exclusion as a Core Competition Concern," 78 *Antitrust L. J.* 527 (2013)