

04-02: *US v. Microsoft*

Hanno Kaiser
Silicon Valley Antitrust v.3, U.C. Berkeley Boalt Hall School of Law
September 2013



This work is licensed under the Creative Commons Attribution 3.0 United States License. To view a copy of this license, visit <http://creativecommons.org/licenses/by/3.0/us/> or send a letter to Creative Commons, 171 Second Street, Suite 300, San Francisco, California, 94105, USA.

Contact me at: [hanno \[at\] wobie.com](mailto:hanno@wobie.com)

US v. Microsoft: Thumbnail summary

Claim	District court	D.C. Cir
Monopolization of PC OS market	§2 (+)	§2 (+)
Attempted monopolization of browser market	§2 (+)	§2 (-)
Tying of Windows and IE	§1 (+) per se	§1 (+/-) ROR

Remedy: District court (Jackson)	D.C. Cir	Actual remedy (Kollar-Kotelly)
Break-up: OS v. everything else	Vacated and remanded	

- The *U.S. v. MSFT* case is about MSFT's various actions to defend its PC OS monopoly against the emergence of interoperability layers.
 - MSFT had a stable PC OS monopoly as a result of indirect network effects ("application barrier to entry")
 - Netscape (NN) and Sun (Java) threatened to erode the entry barrier through middleware
 - MSFT used contracts, threats, deception, technological tying, etc. to keep NN and Java from gaining critical mass
- Who won? As a legal matter DOJ.
 - But in practice, MSFT avoided harsh remedies under the Bush administration.
- Why is *MSFT* so important?
 - Standard antitrust tools apply to dynamic network industries
 - Indirect network effects can be important barriers to entry
 - "Nascent threats" are protected by §2 before they rise to the level of full-blown market participants
 - IP is not an absolute defense ("baseball bat analogy")
 - *Per se* tying does not apply to platform technologies

The MSFT case is about protecting Windows against interoperability layers

- The District Court condemned a number of provisions in Microsoft's agreements licensing Windows to OEMs, because it found that Microsoft's imposition of those provisions (like many of Microsoft's other actions at issue in this case) **serves to reduce usage share of Netscape's browser and, hence, protect Microsoft's operating system monopoly.**
- Browser usage share is important because ... a browser (or any middleware product, for that matter) must have a **critical mass of users in order to attract software developers** to write applications relying upon the APIs it exposes, and away from the APIs exposed by Windows. (60)
- If a consumer could have access to the applications he desired — regardless of the operating system he uses — simply by installing a particular browser on his computer, **then he would no longer feel compelled to select Windows in order to have access to those applications; he could select an operating system other than Windows based solely upon its quality and price.** In other words, the market for operating systems would be competitive. (60)

Key finding: Indirect network effects can be barriers to entry

- “[A] firm cannot possess monopoly power in a market unless that market is also protected by significant barriers to entry.” Id, 82.
- MSFT is selling software, i.e., bits on CDs. Neither programming talent nor distribution are unduly rare or costly. Software development for Windows is non-exclusive. What then constitutes the entry barrier? **Indirect network effects!**
 - “That barrier — the "applications barrier to entry" — stems from two characteristics of the software market: (1) most consumers prefer operating systems for which a large number of applications have already been written; and (2) most developers prefer to write for operating systems that already have a substantial consumer base. ... This "chicken-and-egg" situation ensures that applications will continue to be written for the already dominant Windows, which in turn ensures that consumers will continue to prefer it over other operating systems.” Id, 55.
- This finding is important for multi-sided networked platforms. Even services running on open hard- and software (e.g., LAMP stack) can have market power based on direct and indirect network effects.
- Note the court’s implied assumption that “more is always” better—but that this is not always true. Many two-sided platforms impose restrictions on users and developers to keep “low quality” or outright disruptive participants out.

Direct and indirect network effects

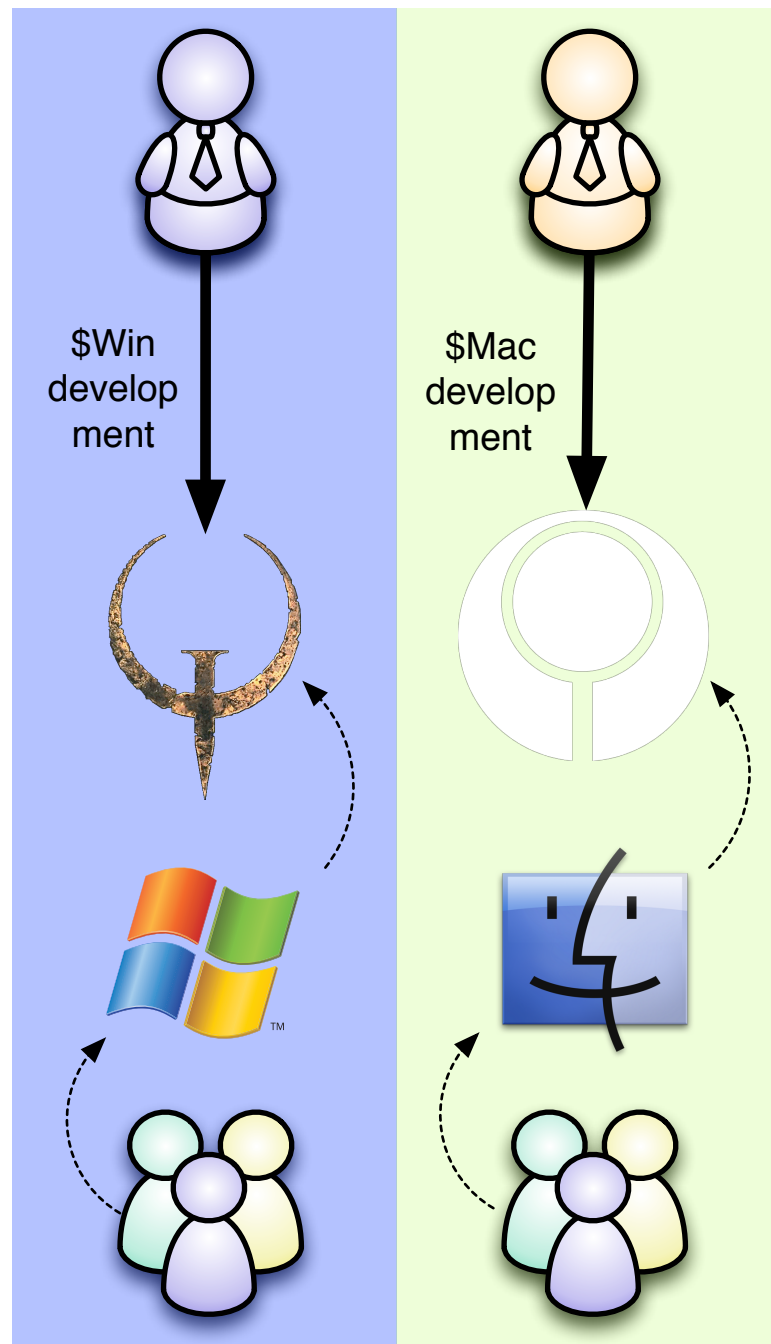
"Users go where the information is so people bring more information to us. Advertisers go where the users are, so we get more advertisers. We get more users because we have more advertisers because we can buy distribution on sites that understand that our search engine monetizes better. So more users more information, more information more users, more advertisers more users, more users more advertisers, it's a beautiful thing, lather, rinse, repeat, that's what I do for a living." Jonathan Rosenberg, Google

- **Direct network effects:** The more users join a network, the more valuable the network becomes for each user. (E.g., telephone, IM). (Same-side effects)
- **Indirect network effects:** The more users there are on one side of a platform (e.g., users of an OS), the greater the value of the platform to another constituency (e.g., application developers for the OS)—and vice versa. (Other-side effects).
- A multi-sided platform often has both direct and indirect network effects, e.g., Facebook.
 - Direct effects = deeper pool of friends.
 - Indirect effects = greater advertiser value.
- Advertisers care about user reach, but do users care about advertisers? Yes. Even if users don't care about the ads (e.g., use ad blockers), they still care about the advertiser financing the platform provider.

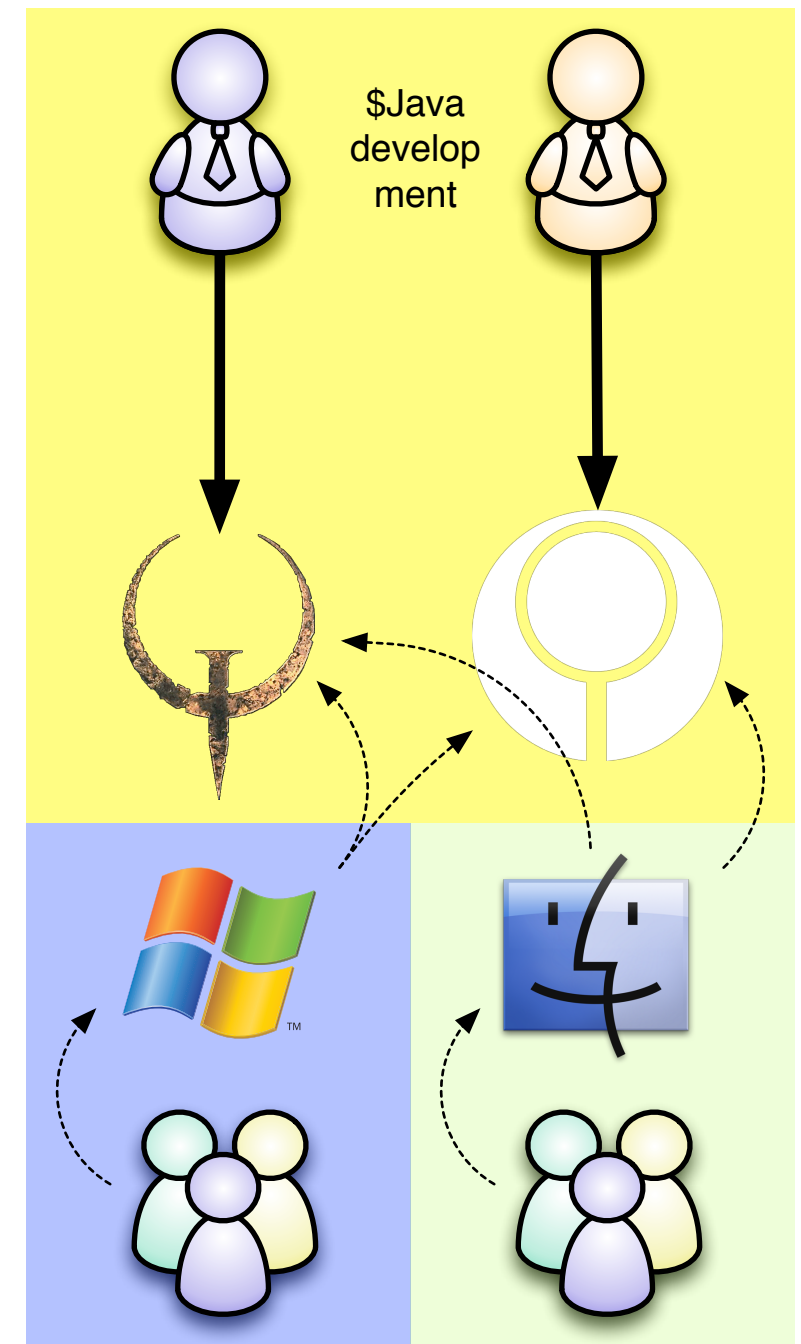
Key finding: Interoperability layers may constitute “nascent threats”

- If indirect network effects can be a basis of market power, then anything that threatens to erode the network effects can be a competitive threat
- Networks effects that are rooted in (or protected by) incompatibility can be threatened by interoperability layers—a now common theme
 - “If a consumer could have access to the applications he desired — regardless of the operating system he uses — simply by installing a particular browser on his computer, then he would no longer feel compelled to select Windows in order to have access to those applications; he could select an operating system other than Windows based solely upon its quality and price. In other words, the market for operating systems would be competitive.” *Id.*, 60.
- It is not entirely clear whether the court thought that Java itself could grow up to become a “viable platform substitute[,],” (79) resulting in head-to-head *Windows v. Java* competition or whether Java/NN would merely enable greater competition *Windows v. MacOS* and *Windows v. Linux* competition.

Interoperability layers (such as Java) have the potential to erode the entry barriers



- Users choose an OS as (a) a gateway to gain access to apps and (b) because of actual OS features
- If apps were written for Java, then OSs would only compete on the basis of “genuine OS features”
- E.g., greater privacy, security and lower cost of Linux or FreeBSD compared to proprietary OSs
- Developers facing the choice of investing \$500 to reach 1,000 users (Win) or 100 users (Mac) opt for Windows
- But developers facing the choice of investing \$500 to reach 1,000 (Win) or 1,100 (Java) would favor the latter
- This assumes that apps written for interoperability layers are comparable to native apps—which may not always be true
- Interoperability layers do not take advantage of many OS innovations—lowest common denominator problem



Exclusionary conduct

- “[T]o be condemned as exclusionary, a monopolist's act must have an anticompetitive effect. That is, it must harm the competitive process and thereby harm consumers.” *U.S. v. Microsoft*, 253 F.3d 34, 58 (D.C.Cir. 2001)
- http://hannokaiser.com/other/2007_msft_exclusion.pdf

Key finding: Weak contributing factor causation requirement

- Normally, exclusionary conduct must significantly contribute to the creation or maintenance of the monopoly power
- But for “nascent threats,” according to the MSFT court:
 - [T]he question ... is not whether Java or NN would actually have developed into viable platform substitutes, but (1) whether as a general matter the exclusion of nascent threats is the type of conduct that is reasonably capable of contributing significantly to a defendant's continued monopoly power and (2) whether Java and Navigator reasonably constituted nascent threats at the time Microsoft engaged in the anticompetitive conduct at issue. (79)
- That is a rather abstract causation standard. Consider this:
 - [T]he question ... is not whether A shot B, but (1) whether as a general matter shooting at someone is the type of conduct that is reasonably capable of contributing significantly to a person's demise and (2) whether A firing his gun in B's direction reasonably constituted “shooting at someone.”
- The MSFT court's causation standard places “nascent threats” in a special antitrust protected class
 - Note that the D.C. Cir. partially tightened the causation requirements in *Rambus Inc. v. FTC*, 522 F.3d 456 (D.C. Cir. 2008)

Monopolization checklist

- Monopoly power
 - Direct proof; and/or
 - Circumstantial proof
 - Market definition (hM + SSNIP and/or *Brown Shoe* factors)
 - Significant market share
 - Barriers to entry
- Exclusionary conduct
 - Harms rivals (foreclosure) = AE
 - Does not benefit consumers (i.e., no plausible business justification) = PE
- Causation
 - The exclusionary conduct (AE>PE) creates or reinforces the monopoly power