IP ANTITRUST ISSUES IN THE MICROSOFT CASE

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I. Procedural History of the Microsoft Case.

A. The United States (Antitrust Division) filed a civil complaint on May 18, 1998, alleging that Microsoft had engaged in anticompetitive conduct in violation of Sections 1 and 2 of the Sherman Act, 15 U.S.C. §§ 1, 2. Simultaneously, twenty states and the District of Columbia (hereinafter "the States") filed a similar, but not identical, action challenging much of the same conduct. At Microsoft's request, the two cases were consolidated. (The cases were de-consolidated on February 2, 2002.)

B. The United States and the States coordinated the pretrial preparation and trial of the case. In a bench trial lasting from October 19, 1998, to June 24, 1999, (78 trial days), the court heard testimony from 26 witnesses, admitted depositions of 79 other witnesses and admitted 2733 exhibits. On November 5, 1999, the court entered 412 findings of fact. *United States v. Microsoft Corp.*, 84 F. Supp. 2d 9 (D.D.C. 1999) ("*Findings of Fact*").

C. Between November 1999 and April 2000, the parties attempted unsuccessfully to settle the suit through mediation before antitrust scholar Judge Richard Posner.

D. The district court then entered its conclusions of law on April 3, 2000. 87 F. Supp. 2d 30 (D.D.C. 2000) ("*Conclusions of Law*"). After further proceedings on remedy, the district court entered its final judgment, which judgment included provision for the breakup of Microsoft and interim conduct relief. 97 F. Supp. 2d 59 (D.D.C. 2000) ("Initial Final Judgment" (IFJ)).

E. The district court ruled that Microsoft successfully had engaged in a series of anticompetitive acts to protect and *maintain* that monopoly, in violation of Section 2 of the Sherman Act. *Conclusions of Law* at 37-44. (Note: the plaintiffs never contended that Microsoft unlawfully had *obtained* its monopoly in Intel-compatible personal computer (PC) operating systems.). The court also ruled that Microsoft unlawfully had attempted to monopolize the Internet Web browser market and had tied its Web browser, Internet Explorer (IE), to its Windows operating system. *Id.* at 45-51. The district court rejected plaintiffs' claim that Microsoft's exclusive dealing contracts violated Section 1 of the Sherman Act. *Id.* at 51-54.

F. To remedy the violations, the court ordered Microsoft to break up into separate operating system and applications businesses. Initial Final Judgment, 97 F. Supp. 2d at 64-65. The Initial Final Judgment also ordered interim conduct restrictions until the structural relief became effective. *Id.* at 66-69.

G. Microsoft filed notices of appeal, and the Court of Appeals, sua sponte, ordered that any proceedings before it be heard en banc. The district court certified the case for direct appeal to the Supreme Court pursuant to the Expediting Act of 1903, as amended, 15 U.S.C. § 29(b), and stayed its judgment pending completion of the appellate process. Order (June 20, 2000). The States filed a petition for certiorari as well. The Supreme Court declined to accept the appeal, denied the States' cert petition, and remanded the case to the Court of Appeals. *Microsoft Corp. v. United States*, 530 U.S. 1301 (2000).

II. Court of Appeals Decision.

A. After extensive briefing and two days of oral argument, the en banc Court of Appeals issued a unanimous (7-0) and comprehensive decision affirming in part, reversing in part, and remanding in part for proceedings before a different district judge. *United States v. Microsoft Corp.*, 253 F.3d 34 (D.C. Cir. 2001) (en banc) ("*Microsoft*").

B. The Court of Appeals affirmed the district court's principle ruling that Microsoft unlawfully had maintained its operating system monopoly by a series of acts that eliminated two "middleware" threats that could have eroded Windows favorable position. *Id.* at 50-80. "Middleware" is platform software that runs on an operating system but also exposes its own application programming interfaces (APIs) so that other applications can run on the middleware itself. *Id.* at 53; *Findings of Fact*, ¶ 28. Where the middleware is cross-platform (i.e., able to run on multiple operating systems), an applications program written to rely exclusively on a middleware program's APIs could run on a computer regardless of the operating system running. Thus, the Court of Appeals found that middleware poses a potential threat to Microsoft's operating system monopoly because if enough applications developers (known as independent software vendors (ISVs)) write enough applications for widely used middleware, computer users no longer would be reluctant to choose a non-Windows operating system for fear that it would run an insufficient array of applications. *Id.* at 53. Over time, this dynamic would erode the "applications barrier to entry" that protected Microsoft's Windows monopoly.

C. Microsoft's anticompetitive acts centered on two middleware threats: Netscape's web browser (Navigator), and Sun Microsystem's Java technologies. To eliminate Navigator's threat, Microsoft set out to ensure that its own web browser, IE, gained dominant usage so that ISVs would continue to focus their efforts on the Windows platform rather than the Navigator platform. Microsoft took steps to constrict Netscape's access to the distribution channels.

D. Java technologies enabled developers to write programs that could be ported to different operating systems with relative ease thereby posing a middleware threat to Microsoft. In 1995, Netscape had announced that it would include a Java Virtual Machine (JVM) with every copy of Navigator, thereby creating the possibility that Sun's Java implementation would achieve the necessary ubiquity on Windows to pose a threat to the applications barrier to entry. *Id.* at 74. Thus, by limiting the usage of Navigator, Microsoft simultaneously limited the distribution of Java. In addition, Microsoft took additional steps to inhibit the distribution of Java: (1) pressuring developers not to support cross-platform Java (*id.* at 75); (2) seeking to eliminate the Java threat through technological means that maximized the difficulty with which applications written in Java could be ported from Windows to other platforms, and vice versa (*id.* at 74-75); and (3) other anticompetitive steps to discourage developers from creating Java applications compatible with non-Microsoft JVMs (*id.* at 75-77).

E. In affirming liability for monopoly maintenance, however, the Court of Appeals upheld twelve of the twenty district court findings that particular acts constituted bases for violations of Section 2. *See id.* at 59-78. These findings can be grouped into four categories of conduct including that Microsoft:

1. undertook a variety of restrictions on OEMs (253 F.3d at 59-64);
2. integrated its Web browser, IE, into Windows in a non-removable way while excluding rivals (*id.* at 64-67);
3. engaged in restrictive and exclusionary dealings with IAPs, ISVs, and Apple Computer (*id*. at 67-74); and
4. threatened and attempted to mislead software developers in order to contain and subvert Java middleware technologies that threatened Microsoft's operating system monopoly (*id.* at 75-77).

F. The court rejected certain trial court findings that Microsoft had violated Section 2 by:

1. prohibiting OEMs from "automatically launching a substitute user interface upon completion of the boot process" (*id.* at 63);
2. overriding the user's choice of browser in certain circumstances (*id.* at 67);
3. giving away its Internet Explorer browser to IAPs and ISVs (*id.* at 67-68, 75);
4. offering IAPs a bounty for each customer the IAP signs up for service using the IE browser (*id.* at 67-68);
5. developing and giving away the Internet Explorer Access Kit (IEAK) (*id.* at 68);
6. entering into exclusive agreements with Internet Content Providers (ICPs) (*id.* at 72);
7. creating a JVM that runs faster on Windows but lacks the cross-platform attributes that Sun's (hence Navigator's) JVM possesses (*id.* at 74-75).

G. The Court of Appeals expressly rejected the district court's conclusion that, "apart from Microsoft's specific acts, Microsoft was liable under § 2 based upon its general 'course of conduct.'" *Id.* at 78. The court found that the district court had failed to "point to any series of acts, each of which harms competition only slightly but the cumulative effect of which is significant enough to form an independent basis for liability." *Id.*

H. The Court of Appeals also reversed the district court's conclusion regarding Microsoft's attempt to monopolize the Web browser market in violation of Section 2. *Id.* at 80-84. The court found that plaintiffs had failed to define and prove a market for Web browsers, a necessary element of the claim. *Id.* at 81-82.

I. The Court of Appeals vacated the district court's judgment on the Section 1 tying claim as well, but remanded that claim to the district court for reconsideration under the rule of reason. *Id.* at 84-97. In dicta, the Court of Appeals held that the market for platform software presented unique issues under tying law suggesting a balancing test in place of the per se rule. The court directed that on remand, plaintiffs would be limited to proving that the anticompetitive effects from tying outweigh the benefits in the *tied* product market, not just that those effects outweigh the benefits overall. *Id.* at 95. In addition, plaintiffs would be "precluded from arguing any theory of harm that depends on a precise definition of browsers or barriers to entry . . . other than what may be implicit in Microsoft's tying arrangement." *Id.*

J. In light of its determination that it had "drastically" (*id.* at 105, 107) altered the district court's conclusions on liability, and its finding that an evidentiary hearing on remedy was necessary (*id.* at 101-103), the Court of Appeals vacated the final judgment and remanded the case to the district court for further proceedings. *Id.* at 107. The court also offered "guidance . . . to advance the ultimate resolution of this important controversy" suggesting that a structural remedy was not supported by the evidence. *Id.* at 105.

K. The Court of Appeals admonished the district court on remand to bear in mind the role of causation when fashioning relief, directing this Court to "consider whether plaintiffs have established a sufficient causal connection between Microsoft's anticompetitive conduct and its dominant position in the [operating system] market." *Id.* at 106. Absent "clear[]" indication of a "'*significant causal* *connection* between the conduct and creation or maintenance of the market power,'" Microsoft's unlawful behavior "should be remedied by 'an injunction against continuation of that conduct.'" *Id.* at 106 (quoting 3 Phillip E. Areeda & Herbert Hovenkamp, *Antitrust Law* ¶ 650a, at 67 (rev. ed. 1996)) (emphasis added by Court of Appeals).

L. Finally, the Court of Appeals concluded that the district judge's contacts with the press violated the Code of Conduct for United States Judges and warranted disqualification under 28 U.S.C.§ 455(a). *Id.* at 107-118. The court vacated the remedy on the additional basis that the district judge's misconduct infected the remedial phase. *Id.* at 117. The Court of Appeals rejected Microsoft's procedural challenges to the trial court proceedings, finding the district court's actions "comfortably within the bounds of its broad discretion to conduct trials as it sees fit." 253 F.3d at 98, 100-01.

III. Remand to District Court.

A. After the decision, the Court of Appeals rejected Microsoft's petition for rehearing which had attempted to revise the decision to reverse the trial court's finding that Microsoft's intermingling of code between the browser and the operating system was anticompetitive. Microsoft filed a petition for a writ of certiorari based on the Court of Appeals' failure to vacate the *Findings of Fact* and *Conclusions of Law* — and not just the remedy — in light of the district judge's misconduct. Petition for a Writ of Certiorari, No. 01-236 ("Cert. Petition") was denied. *Microsoft Corp. v. United States*, 122 S. Ct. 350 (2001).

B. On September 28, 2001, the new trial judge ordered the parties into a new round of intense settlement negotiations and probable mediation. The Court directed plaintiffs to "determine which portions of the former judgment remain appropriate in light of the appellate court's ruling and which portions are unsupported following the appellate court's narrowing of liability." Tr. 9/28/01 at 8. The Court also adopted a fast-track discovery and evidentiary hearing schedule in case the parties failed to settle.

C. On November 2, 2001, following five weeks of intensive negotiation and mediation, the United States and Microsoft agreed on terms of a proposed final judgment. Further negotiations with several of the plaintiff States resulted in submission on November 6, 2001, by the United States, the Settling States (New York, Ohio, Illinois, Kentucky, Louisiana, Maryland, Michigan, North Carolina, and Wisconsin), and Microsoft of the Revised Proposed Final Judgment (RPFJ). As of April 2002, the RPFJ is pending before the district court. The RPFJ provides for OEM protection, nondiscriminatory treatment of ISVs, the modularization of platform software sold with Windows, disclosure of APIs and other interfaces sufficient to enable the development of compatible applications software and an extensive compliance regime.

D. Several states (California, Massachusetts, Kansas, Utah, Iowa, Connecticut, West Virginia, Minnesota, Florida) and the District of Columbia chose not to enter into the RPFJ. On March 18, 2002, a hearing commenced in the district court on the non-settling states proposed remedy which includes relief provisions similar to the RPFJ in some respects but also contains other provisions requiring Microsoft to disclose and license the source code for IE, to distribute Java with Windows for ten years, to allow for the porting of Office to other operating systems, and to adhere to industry standards if Microsoft claims that its products are compliant.

IV. Intellectual Property Aspects of the Microsoft Litigation.

A. At various points during the litigation, Microsoft attempted to raise defenses to the core antitrust allegations based not on antitrust law but on copyright law. Microsoft's motion for summary judgment on the grounds that its IP rights shielded its conduct was denied in a decision on September 14, 1998. 1998 WL 614485 at *15 (D.D.C. Sept. 14, 1998).

B. Even though Microsoft had been put on notice that a blanket exemption was not available under the copyright law, Microsoft did not offer any evidence at trial related to the IP defense issue other than the fact that Microsoft's operating systems received copyright protection, a fact not disputed by the government. As a result, the trial judge rejected the IP defense stating that it is "well settled that a copyright holder is not by reason thereof entitled to employ the prerequisites in ways that directly threatens competition." United States v. Microsoft Corp., 87 F. Supp. 30, 40 (D.D.C. 2000). Indeed, given the lack of vigor with which Microsoft pursued this defense at trial, the trial began his discussion of the IP issues stating "To the extent that Microsoft still asserts a copyright defense . . ." Id.

C. The district issued only one Finding of Fact dealing directly with the IP issues. Finding 228 stated in its entirety:

> Like most other software products, Windows 95 and Windows 98 are covered by copyright registrations. Since they are copyrighted, Microsoft distributes these products to OEMs pursuant to license agreements. By early 1998, Microsoft had made these licenses conditional on OEMs' compliance with the restrictions described above. Notwithstanding the formal inclusion of these restrictions in the license agreements, the removal of the Internet Explorer icon and the promotions of Navigator in the boot sequence would not have compromised Microsoft's creative expression or interfered with its ability to reap the legitimate value of its ingenuity and investment in developing Windows. More generally, the contemporaneous Microsoft documents reflect concern with the promotion of Navigator rather than the infringement of a copyright.

D. Microsoft essentially repeated to the Court of Appeals the arguments that had been made in the trial court, essentially that "the license restrictions are legally justified because, in imposing them, Microsoft is simply 'exercising its rights as the holder of valid copyrights.'" 253 F.3d at 62.

E. The Court of Appeals dealt with Microsoft's IP arguments almost as summarily as the trial court:

> Microsoft's primary copyright argument borders upon the frivolous. The company claims an absolute and unfettered right to use its intellectual property as it wishes: "[I]f intellectual property rights have been lawfully acquired," it says, then "their subsequent exercise cannot give rise to antitrust liability." Appellant's Opening Br. at 105. That is no more correct than the proposition that use of one's personal property, such as a baseball bat, cannot give rise to tort liability. As the Federal Circuit succinctly stated: "Intellectual property rights do not confer a privilege to violate the antitrust laws." 253 F.3d at 63 (relevant pages attached).

F. In addition, Microsoft made two arguments to the effect that it was not unreasonably exercising its copyright in an unreasonable manner.

1. First, Microsoft cites *Gilliam v. ABC*, 538 F.2d 14 (2d Cir. 1976); *WGN Cont'l Broad.Co. v. United Video, Inc.*, 693 F.2d 622 (7th Cir. 1982) for the proposition that a copyright holder may limit a licensee's ability to engage in "significant and deleterious alterations" of a copyrighted work. The Court of Appeals distinguished those cases from the Microsoft fact pattern on the grounds that those cases involved "substantial alterations" and neither involved any claim that the copyright holder had violated the antitrust laws. 253 F.3d at 63. The only license restriction Microsoft "seriously defends as necessary to prevent a 'substantial alteration' of its copyrighted work is the prohibition on OEMs automatically launching a substitute user interface upon completion of the boot sequence." *Id.* The Court agreed that allowing OEMs to load a shell program that prevents the user from even seeing the Windows desktop briefly is a substantial alteration and Microsoft's interest in preventing this outweighs the anticompetitive effect it might have.

2. The second variation on the copyright defense posited by Microsoft is that the license restrictions imposed by Microsoft are necessary to prevent OEMs from so altering Windows as to undermine the principal value of Windows as a stable platform for software development. *Id.* The only evidence Microsoft submitted at trial relating indirectly to this justification was an exhibit that mentioned the possible consumer confusion that might result if OEMs added programs to the desktop. But the Court rejected this outright noting that the OEMs bear the bulk of the costs caused by consumer confusion in the form of increased consumer complaints and calls for assistance. The only rational explanation for this restriction was that addition of such programs to the desktop undermines Microsoft's monopoly and "that is not a permissible justification for license restrictions." *Id.* at 64.

G. Microsoft argued that its restrictions and other actions did not completely bar Netscape from distributing its product. Although noting that this was technically correct, the Court pointed out that Microsoft "did bar [Netscape] from the cost-efficient ones [or means of distribution]." *Id.* at 64.

H. Microsoft also made arguments justifying its technological bundling of its software with Windows. These attempts to justify its conduct were not explicitly premised on intellectual property rights. However, they provide a useful backdrop to these IP issues in future cases. The three specific circumstances include:

1. In Windows 98, unlike Windows 95, Microsoft did not allow Internet Explorer to be removed using Windows Add/Remove function;

2. Microsoft designed Windows to override the users choice of a default browser for a variety of Windows functions; and

3. Microsoft had commingled the code from IE and Windows such that any attempt to remove IE files would cripple parts of Windows.

I. First, the Court of Appeals found that each of these restrictions was anticompetitive because it reduced user choice. The second step of the analysis weighed the anticompetitive effect against Microsoft's proffered justifications. With respect to the first and third items, Microsoft's justifications were insufficient. With respect to the aspect of Windows that allows for the override of the user's choice of browser in certain situations, the Court held that such a justification did outweigh the anticompetitive effect.