

Monopoly in the computer software industry

The Microsoft case

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A legal and public relations battle has flared up in the long-standing US Department of Justice (DOJ) investigation into Microsoft's business practices. Last week began with leaks from the DOJ about a potential expansion of the federal legal inquiry. This was followed by reports that 11 states may initiate legal action against Microsoft. The week closed with press reports about a Microsoft campaign to counter the states' potential lawsuit by preparing a display of 'grassroots support,' complete with planted letters to newspaper editors.

The Justice Department's investigation began in August 1993 when it took over the Microsoft case from the Federal Trade Commission. Following the exposure of a number of strong-arm tactics to undermine its rivals, Microsoft reached a settlement, called a consent decree, with the DOJ in 1995. Microsoft agreed not to engage in a number of practices, without admitting guilt for any of the alleged offenses.

Microsoft's rivals in the computer software industry charged that the software giant had attempted to exploit its dominant position in operating systems software (such as DOS and Windows) to gain an illegitimate advantage, in establishing a monopoly in operating systems as well as boosting sales of its applications software (like Microsoft Word).

Microsoft had, for example, established contracts with computer makers that charged for each computer produced, regardless of whether it contained a Microsoft operating system. Such deals, presented as volume discounts, effectively forced manufacturers into exclusive deals with Microsoft. This was prohibited in the 1995 consent decree.

Microsoft had also been charged with pressuring personal computer makers to install Microsoft application software as a condition of installing its operating system software. It was alleged, for example, that computer makers were given steep discounts for installing both its operating systems (e.g., Windows) and its applications software (e.g., Microsoft Word). Because computer makers wanted to install the Windows operating system, which was becoming a standard for desktop computers, they had a financial incentive to install the other software from Microsoft. This practice, generally referred to as 'tying,' was also prohibited in the decree.

The 1995 settlement did not resolve all of the disputes among software manufacturers. The rapid growth of the Internet and the World Wide Web since 1994 augmented the importance of software in information technology, and in economic life in

general. This sparked new conflicts between Microsoft and its rivals.

In the late summer of 1995 Microsoft launched a new version of its operating system, Windows 95, which quickly grabbed the market for desktop operating systems. Ninety percent of today's new desktop computers are sold with Windows 95 installed. Microsoft's monopoly on desktop operating systems has been lucrative. It was responsible for \$5 billion of the \$11.5 billion in the company's fiscal 1997 revenues.

The growth of the Internet challenged Microsoft's position in both the operating system and application software businesses. While it amplified the need for standards that would allow different computers around the world to work together, it opened the door to the adoption of standards outside of Microsoft's sphere of control.

Documents on the Web, including this one, contain elementary formatting that was previously done only on word processor software programs (such as Microsoft Word). On the Web, one can receive a formatted document without using such a program. Not only do Web documents not require word processors, they can be read by computers which use a variety of operating systems, not only Windows 95, but also those of competitors like Apple. Though the Web's language, Hypertext Mark-Up (HTML), is very limited and does not include all of the features associated with word processors, new types of programs and standards developed in recent years can do much more.

Microsoft undercut its rivals in Internet computing, triggering their complaints and the latest actions by the DOJ. The company developed a Web browser, Internet Explorer, following the introduction of Netscape's Navigator. Having decided that it could not capture more of the market from Netscape simply by giving the browser away (as Netscape had), it opted to package Internet Explorer with Windows 95. In October 1997 the DOJ filed suit against Microsoft for forcing computer makers to install Internet Explorer (and preventing them from offering Navigator) if they install Windows 95. The DOJ claimed that Microsoft's actions violated the 1995 consent decree's ban on tying the purchase of one of its products to the purchase of another.

In court in December, Microsoft claimed that Internet Explorer had been integrated into Windows 95, a process permitted by the consent decree, and could not be sold separately without undermining the operating system. US District Judge Thomas Jackson appointed a technical expert, Professor Lawrence Lessig

of Harvard University, to make a recommendation about the products' integration. In the meantime he ruled that Microsoft had to offer computer manufacturers the option of installing a version of Windows 95 without Internet Explorer.

Microsoft's reply was to offer computer makers three options: take an older version of Windows 95 without Internet Explorer (and lose out on any recent improvements), take a new version of Windows 95 without Internet Explorer (which would not operate properly), or accept the bundled package. The DOJ sought contempt charges against Microsoft for effectively seeking to moot Jackson's order. A hearing in January 1998 resolved the contempt charge by allowing Microsoft to distribute the bundled package so long as it offered a version that did not include an Internet Explorer icon on the desktop, the screen seen when a computer is turned on.

Microsoft is appealing the December 1997 injunction, including the appointment of Lessig, whom it accuses of 'exhibiting clear bias against Microsoft.' This is a rather specious charge, substantiated only by a July 1997 e-mail message Lessig sent to an acquaintance at Netscape in which he inquired about a potential incompatibility between Internet Explorer and Navigator. Both the injunction and the Lessig appointment are scheduled to be addressed at an April 21 court hearing.

The government investigation was furthered by a March 3 Senate Judiciary Committee hearing where Microsoft founder Bill Gates and five other software company CEOs appeared. Titled 'Market Power and Structural Change in the Software Industry,' it was chaired by Utah Senator Orin Hatch. Although little new information came out of the hearing, Hatch did secure Gates's consent to release computer makers from confidentiality agreements, allowing them to speak to investigators about Microsoft's business practices.

The case took another turn last week, when the *Wall Street Journal* reported that the DOJ was preparing a broader antitrust case against Microsoft before the scheduled May 15 release of its upgrade of Windows 95 (Windows 98). The suit will likely aim to force Microsoft to offer a version of the operating system without Internet Explorer, though stronger measures like a split-up of the company have also been discussed in business and government circles.

Also last week the *Seattle Times*, citing anonymous sources, reported that 11 states, several of which are home to Microsoft rivals, are considering filing suit against the company along the same lines as the DOJ's October 1997 lawsuit. Microsoft's response, according to company documents later obtained by the *Los Angeles Times*, has been to launch a public relations blitz aimed at demonstrating popular support for Microsoft. The campaign is to include ads in several US papers warning of 'threats to innovation' without referring specifically to the DOJ case. It is also to involve letters to newspaper editors drafted by Microsoft's public relations representatives, but appearing in the name of others.

At stake in these legal battles is control over not only the \$250 billion software market, but the related information technology field which is already worth \$1 trillion annually. Although Microsoft's revenues are a small fraction of this amount, its

strategy of integrating Internet Explorer into Windows 95 and its other efforts to gain a greater foothold in Internet business have angered its rivals. Recently, they have alleged that Microsoft is taking advantage of its control of the computer desktop to put icons there that direct consumers to its Web sites, Internet Service Providers and related businesses. They have also pointed out deals that give Internet Service Providers discounts on Microsoft software if they arrange to have their clients install Internet Explorer.

The intervention of the Justice Department and a section of Congress reflects, at least in part, the complaints of these rivals and other corporate interests which have become increasingly concerned about the economic power of Microsoft. As hardware prices fall (see related story), software becomes an increasingly large share of the total purchase price of a computer. Three years ago, a Microsoft operating system cost \$50 while the total machine cost \$3,000. Today the figures are \$100 and \$1,000 respectively, with the latter expected to be cut in half in two years. (Other standard office software costs \$200-500, depending upon how it is purchased.) Recent articles in the financial press have also noted that Microsoft has pushed its way into the business of providing access to the Internet at a time when older, more established companies, like the traditional telecommunications carriers, are pursuing a similar course.

One question raised by the investigation is whether Microsoft's rivals, if they found themselves with the upper hand, would operate in a fundamentally different manner. Sun and Novell, for example, already offer similar bundled operating system-Internet browser packages. One point can safely be made: So long as the industry remains privately owned, the socially useful processes of computer proliferation and standardization will be accompanied by the reactionary concentration of wealth and control in the hands of a relatively small number of industry magnates and big shareholders.

See also:
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