UNITED STATES V. MICROSOFT CORP., 253 F.3D 34 (D.C.CIR. 2001)
EXCERPTS

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PER CURIAM:

Microsoft Corporation appeals from judgments of the District Court finding the company in violation of §§ 1 and 2 of the Sherman Act and ordering various remedies. {45}

The District Court determined that Microsoft had maintained a monopoly in the market for Intelcompatible PC operating systems in violation of § 2; attempted to gain a monopoly in the market for internet browsers in violation of § 2; and illegally tied two purportedly separate products, Windows and Internet Explorer ("IE"), in violation of § 1. {45}

To remedy the Sherman Act violations, the District Court issued a Final Judgment requiring Microsoft to submit a proposed plan of divestiture, with the company to be split into an operating systems business and an applications business. {45}

I. INTRODUCTION {47}

A. Background {47}

[...]

B. Overview {48}

Before turning to the merits of Microsoft's various arguments, we pause to reflect briefly on two matters of note, one practical and one theoretical. {48}

The practical matter relates to the temporal dimension of this case. {48}

> [I]t is noteworthy that a case of this magnitude and complexity has proceeded from the filing of complaints through trial to appellate decision in a mere three years. {48}
>
> What is somewhat problematic, however, is that just over six years have passed since Microsoft engaged in the first conduct plaintiffs allege to be anticompetitive. As the record in this case indicates, six years seems like an eternity in the computer industry. {49}
>
> Conduct remedies may be unavailing in such cases, because innovation to a large degree has already rendered the anticompetitive conduct obsolete. {49}
>
> [H]ow a court goes about restoring competition to a dramatically changed, and constantly changing, marketplace. {49}
>
> [T]he threat of private damage actions will remain to deter those firms inclined to test the limits of the law. {49}

The second matter of note is more theoretical in nature. We decide this case against a backdrop of significant debate amongst academics and practitioners over the extent to which "old economy" § 2 monopolization doctrines should apply to firms competing in dynamic technological markets characterized by network effects. {49}

> Once a product or standard achieves wide acceptance, it becomes more or less entrenched. Competition in such industries is "for the field" rather than "within the field." {49}
>
> In technologically dynamic markets, however, such entrenchment may be temporary, because innovation may alter the

field altogether. {49}

Indeed, there is some suggestion that the economic consequences of network effects and technological dynamism act to offset one another, thereby making it difficult to formulate categorical antitrust rules absent a particularized analysis of a given market. {50}

II. MONOPOLIZATION {50}

Section 2 of the Sherman Act makes it unlawful for a firm to "monopolize." 15 U.S.C. § 2. The offense of monopolization has two elements: "(1) the possession of monopoly power in the relevant market and (2) the willful acquisition or maintenance of that power as distinguished from growth or development as a consequence of a superior product, business acumen, or historic accident." {50}

A. Monopoly Power {51}

The Supreme Court defines monopoly power as "the power to control prices or exclude competition." {51}

Where evidence indicates that a firm has in fact profitably done so, the existence of monopoly power is clear. {51}

Because such direct proof is only rarely available, courts more typically examine market structure in search of circumstantial evidence of monopoly power. ... Under this structural approach, monopoly power may be inferred from a firm's possession of a dominant share of a relevant market that is protected by entry barriers. {51}

1. Market Structure {51}

a. Market definition {51}

[T]he relevant market must include all products "reasonably interchangeable by consumers for the same purposes." {52}

[T]he District Court defined the market as "the licensing of all Intel-compatible PC operating systems worldwide." {52}

Microsoft argues that the District Court improperly excluded three types of products: non-Intel compatible operating systems (primarily Apple's Macintosh operating system, Mac OS), operating systems for non-PC devices (such as handheld computers and portal websites), and "middleware" products, which are not operating systems at all. {52}

We begin with Mac OS. ... consumers would not switch from Windows to Mac OS in response to a substantial price increase ... costs of acquiring the new hardware ... compatible software ... learning the new system ... transferring files. {52}

Microsoft responds only by saying: "the district court's market definition is so narrow that it excludes Apple's Mac OS, which has competed with Windows for years, simply because the Mac OS runs on a different microprocessor." ... This general, conclusory statement falls far short of what is required to challenge findings as clearly erroneous. {52}

[T]he District Court found that because information appliances fall far short of performing all of the functions of a PC, most consumers will buy them only as a supplement to their PCs. ... The District Court also found that portal websites do not presently host enough applications to induce consumers to switch, nor are they likely to do so in the near future. {52}

This brings us to Microsoft's main challenge to the District Court's market definition: the exclusion of middleware. {53}

Ultimately, if developers could write applications relying exclusively on APIs exposed by middleware, their applications would run on any operating system on which the middleware was also present. {53}

The District Court found, however, that neither Navigator, Java, nor any other middleware product could now, or would soon, expose enough APIs to serve as a platform for popular applications, much less take over all operating system functions. {53}

> Whatever middleware's ultimate potential, the District Court found that consumers could not now abandon their operating systems and switch to middleware in response to a sustained price for Windows above the competitive level. {54}

Microsoft argues that the District Court should not have excluded middleware from the relevant market because the primary focus of the plaintiffs' § 2 charge is on Microsoft's attempts to suppress middleware's threat to its operating system monopoly. According to Microsoft, it is "contradict[ory].” {54}

Nothing in § 2 of the Sherman Act limits its prohibition to actions taken against threats that are already well-developed enough to serve as present substitutes. {54}

b. Market power {54}

Having thus properly defined the relevant market, the District Court found that Windows accounts for a greater than 95% share. Findings of Fact ¶ 35. The court also found that even if Mac OS were included, Microsoft's share would exceed 80%. {54}

Microsoft claims that even a predominant market share does not by itself indicate monopoly power. Although the "existence of [monopoly] power ordinarily may be inferred from the predominant share of the market," Grinnell, 384 U.S. at 571, 86 S.Ct. 1698, we agree with Microsoft that because of the possibility of competition from new entrants ... looking to current market share alone can be "misleading.”

In this case, however, the District Court was not misled. Considering the possibility of new rivals, the court focused not only on Microsoft's present market share, but also on the structural barrier that protects the company's future position. {55}

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. {55}

[MSFT] argues instead that "[i]t defies common sense" to suggest that an operating system must support as many applications as Windows does (more than 70,000, according to the District Court, id. ¶ 40) to be competitive. ... [H]owever, the applications barrier to entry gives consumers reason to prefer the dominant operating system even if they have no need to use all applications written for it. {55}

[M]iddleware will not expose a sufficient number of APIs to erode the applications barrier to entry in the foreseeable future. {55}

Microsoft next argues that the applications barrier to entry is not an entry barrier at all, but a reflection of Windows' popularity. ... Because the applications barrier to entry protects a dominant operating system irrespective of quality, it gives Microsoft power to stave off even superior new rivals. {56}

Microsoft argues that the District Court should not have considered the applications barrier to entry because it reflects not a cost borne disproportionately by new entrants, but one borne by all participants in the operating system market. ... When Microsoft entered the operating system market with MS-DOS and the first version of Windows, it did not confront a dominant rival operating system with as massive an installed base and as vast an existing array of applications as the Windows operating systems have since enjoyed. {56}

2. Direct Proof {56}

Microsoft cites no case, nor are we aware of one, requiring direct evidence to show monopoly power in any market. We decline to adopt such a rule now. {57}

B. Anticompetitive Conduct {58}

In this case, after concluding that Microsoft had monopoly power, the District Court held that Microsoft had violated § 2 by engaging in a variety of exclusionary acts (not including predatory pricing), to maintain its monopoly by

preventing the effective distribution and use of products that might threaten that monopoly. {58}

> First, to 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. In contrast, harm to one or more competitors will not suffice. {58}
>
> Second, the plaintiff... must demonstrate that the monopolist's conduct indeed has the requisite anticompetitive effect. {59}
>
> Third, ... the monopolist may proffer a "procompetitive justification" for its conduct ... for example, greater efficiency or enhanced consumer appeal. {59}
>
> Fourth, ... the plaintiff must demonstrate that the anticompetitive harm of the conduct outweighs the procompetitive benefit. {59}

[O]ur focus is upon the effect of that conduct, not upon the intent behind it. Evidence of the intent behind the conduct of a monopolist is relevant only to the extent it helps us understand the likely effect of the monopolist's conduct. {59}

1. Licenses Issued to Original Equipment Manufacturers (59)

The District Court ... 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. (59-60)

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. ... 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}

a. Anticompetitive effect of the license restrictions {60}

[H]aving an OEM pre-install a browser on a computer is one of the two most cost-effective methods by far of distributing browsing software. {60}

> [T]he first license restriction—the prohibition upon the removal of desktop icons, folders, and Start menu entries—thwarts the distribution of a rival browser by preventing OEMs from removing visible means of user access to IE. {61}
>
> The OEMs cannot practically install a second browser in addition to IE, the court found, in part because "[p]re-installing more than one product in a given category ... can significantly increase an OEM's support costs, for the redundancy can lead to confusion among novice users." ... That is, a certain number of novice computer users, seeing two browser icons, will wonder which to use when and will call the OEM's support line. Support calls are extremely expensive and, in the highly competitive original equipment market, firms have a strong incentive to minimize costs. {61}
>
> By preventing OEMs from removing visible means of user access to IE, the license restriction prevents many OEMs from pre-installing a rival browser and, therefore, protects Microsoft's monopoly from the competition that middleware might otherwise present. {61}
>
> The second license provision at issue prohibits OEMs from modifying the initial boot sequence—the process that occurs the first time a consumer turns on the computer. (61) ... Because this prohibition has a substantial effect in protecting Microsoft's market power, and does so through a means other than competition on the merits, it is anticompetitive. {62}
>
> Finally, ... Microsoft prohibits OEMs from causing any user interface other than the Windows desktop to launch

> automatically ... [T]his type of license restriction, like the first two restrictions, is anticompetitive: Microsoft reduced rival browsers' usage share not by improving its own product but, rather, by preventing OEMs from taking actions that could increase rivals' share of usage. {62}

b. Microsoft's justifications for the license restrictions {62}

Microsoft argues that the license restrictions are legally justified because, in imposing them, Microsoft is simply "exercising its rights as the holder of valid copyrights." {62}

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." In re Indep. Serv. Orgs. Antitrust Litig., 203 F.3d 1322, 1325 (Fed.Cir.2000). {63}

Microsoft cites two cases indicating that a copyright holder may limit a licensee's ability to engage in significant and deleterious alterations of a copyrighted work. ... We agree that a shell that automatically prevents the Windows desktop from ever being seen by the user is a drastic alteration of Microsoft's copyrighted work, and outweighs the marginal anticompetitive effect of prohibiting the OEMs from substituting a different interface automatically upon completion of the initial boot process. We therefore hold that this particular restriction is not an exclusionary practice that violates § 2 of the Sherman Act. {63}

Apart from copyright, Microsoft ... argues that, despite the restrictions in the OEM license, Netscape is not completely blocked from distributing its product. That claim is insufficient to shield Microsoft from liability for those restrictions because, although Microsoft did not bar its rivals from all means of distribution, it did bar them from the cost-efficient ones. {64}

In sum, we hold that with the exception of the one restriction prohibiting automatically launched alternative interfaces, all the OEM license restrictions at issue represent uses of Microsoft's market power to protect its monopoly, unredeemed by any legitimate justification. The restrictions therefore violate § 2 of the Sherman Act. {64}

2. Integration of IE and Windows {64}

[I]n late 1995 or early 1996, Microsoft set out to bind [IE] more tightly to Windows 95 as a technical matter." ... Technologically binding IE to Windows, the District Court found, both prevented OEMs from pre-installing other browsers and deterred consumers from using them. {64}

a. Anticompetitive effect of integration {65}

As a general rule, courts are properly very skeptical about claims that competition has been harmed by a dominant firm's product design changes. ... Judicial deference to product innovation, however, does not mean that a monopolist's product design decisions are per se lawful. {65}

Microsoft had included IE in the Add/Remove Programs utility in Windows 95, ... but when it modified Windows 95 to produce Windows 98, it took IE out of the Add/Remove Programs utility. ... Because Microsoft's conduct, through something other than competition on the merits, has the effect of significantly reducing usage of rivals' products and hence protecting its own operating system monopoly, it is anticompetitive. {65}

Microsoft designed Windows 98 "so that using Navigator on Windows 98 would have unpleasant consequences for users" by, in some circumstances, overriding the user's choice of a browser other than IE as his or her default browser. {65}

Finally, the District Court condemned Microsoft's decision to bind IE to Windows 98 "by placing code specific to Web browsing in the same files as code that provided operating system functions." {66}

b. Microsoft's justifications for integration {66}

Microsoft proffers no justification for two of the three challenged actions that it took in integrating IE into Windows—excluding IE from the Add/Remove Programs utility and commingling browser and operating system code. Although

Microsoft does make some general claims regarding the benefits of integrating the browser and the operating system ... it neither specifies nor substantiates those claims. {66}

[W]e hold that Microsoft's exclusion of IE from the Add/Remove Programs utility and its commingling of browser and operating system code constitute exclusionary conduct, in violation of § 2. {67}

Microsoft may not be held liable for this aspect [i.e., override the user's choice of a default browser in certain circumstances] of its product design. {67}

3. Agreements with Internet Access Providers {67}

[...]

4. Dealings with Internet Content Providers, Independent Software Vendors, and Apple Computer {71}

[...]

[T]he District Court found that: In 1997, Apple's business was in steep decline, and many doubted that the company would survive much longer. ... Had Microsoft announced in the midst of this atmosphere that it was ceasing to develop new versions of Mac Office, a great number of ISVs, customers, developers, and investors would have interpreted the announcement as Apple's death notice. {73}

[Bill] Gates ... called Apple's CEO ... to ask `how we should announce the cancellation of Mac Office....'" {73}

[W]ithin a month of Gates' call, Apple and Microsoft had reached an agreement pursuant to which Microsoft's primary obligation is to continue releasing up-to-date versions of Mac Office for at least five years.... [and] Apple has agreed ... to "bundle the most current version of [IE] ... with [Mac OS]" ... [and to] "make [IE] the default [browser]".... Navigator is not installed on the computer hard drive during the default installation, which is the type of installation most users elect to employ.... [The] Agreement further provides that ... Apple may not position icons for non-Microsoft browsing software on the desktop of new Macintosh PC systems or Mac OS upgrades. {73}

By extracting from Apple terms that significantly diminished the usage of Navigator on the Mac OS, Microsoft helped to ensure that developers would not view Navigator as truly cross- platform middleware. {74}

Microsoft offers no procompetitive justification for the exclusive dealing arrangement. ... Accordingly, we hold that the exclusive deal with Apple is exclusionary, in violation of § 2 of the Sherman Act. {74}

5. Java {74}

Java, a set of technologies developed by Sun Microsystems, is another type of middleware posing a potential threat to Windows' position as the ubiquitous platform for software development. {74}

In May 1995 Netscape agreed with Sun to distribute a copy of the Java runtime environment with every copy of Navigator, and "Navigator quickly became the principal vehicle by which Sun placed copies of its Java runtime environment on the PC systems of Windows users." Id. ¶ 76. {74}

Microsoft, too, agreed to promote the Java technologies—or so it seemed. {74}

a. The incompatible JVM {74}

The JVM developed by Microsoft allows Java applications to run faster on Windows than does Sun's JVM, Findings of Fact ¶ 389, but a Java application designed to work with Microsoft's JVM does not work with Sun's JVM and vice versa. {74}

[A] monopolist does not violate the antitrust laws simply by developing a product that is incompatible with those of its rivals. {75}

The JVM ... does allow applications to run more swiftly and does not itself have any anticompetitive effect. Therefore, we reverse the District Court's imposition of liability for Microsoft's development and promotion of its JVM. {75}

b. The First Wave Agreements {75}

Microsoft entered into First Wave Agreements with dozens of ISVs to use Microsoft's JVM. {75}

[T]he deals were exclusive in practice because they required developers to make Microsoft's JVM the default in the software they developed. {75}

Because Microsoft's agreements foreclosed a substantial portion of the field for JVM distribution and because, in so doing, they protected Microsoft's monopoly from a middleware threat, they are anticompetitive. {76}

Microsoft offered no procompetitive justification for the default clause that made the First Wave Agreements exclusive as a practical matter. {76}

c. Deception of Java developers {76}

Microsoft's "Java implementation" included, in addition to a JVM, a set of software development tools it created to assist ISVs in designing Java applications. ... [D]evelopers who relied upon Microsoft's public commitment to cooperate with Sun and who used Microsoft's tools to develop what Microsoft led them to believe were cross-platform applications ended up producing applications that would run only on the Windows operating system. {76}

Microsoft denied the accusation and indicated it was only "adding rich platform support" to what remained a cross-platform implementation. {76}

One Microsoft document ... states as a strategic goal: "Kill cross-platform Java by grow[ing] the polluted Java market." GX 259 {76-77}

Microsoft's conduct related to its Java developer tools served to protect its monopoly of the operating system in a manner not attributable either to the superiority of the operating system or to the acumen of its makers, and therefore was anticompetitive. {77}

d. The threat to Intel {77}

In 1995 Intel was in the process of developing a highper-formance, Windows-compatible JVM. Microsoft wanted Intel to abandon that effort because a fast, cross-platform JVM would threaten Microsoft's monopoly in the operating system market. {77}

Intel finally capitulated in 1997, after Microsoft delivered the coup de grace. “[O]ne of Intel's competitors, called AMD, solicited support from Microsoft for its "3DX" technology. ... Gates responded: "If Intel has a real problem with us supporting this then they will have to stop supporting Java Multimedia the way they are. I would gladly give up supporting this if they would back off from their work on JAVA."

Microsoft's threats to Intel were exclusionary, in violation of § 2 of the Sherman Act. {78}

6. Course of Conduct {78}

The District Court held that, apart from Microsoft's specific acts, Microsoft was liable under § 2 based upon its general "course of conduct." ... We need not pass upon plaintiffs' argument, however, because the District Court did not 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. {78}

Because the District Court identifies no other specific acts as a basis for "course of conduct" liability, we reverse its conclusion that Microsoft's course of conduct separately violates § 2 of the Sherman Act. {78}

C. Causation {78}

Microsoft urges this court to reverse on the monopoly maintenance claim, because plaintiffs never established a causal link between Microsoft's anticompetitive conduct, in particular its foreclosure of Netscape's and Java's distribution channels, and the maintenance of Microsoft's operating system monopoly. {78}

According to Microsoft, the District Court cannot simultaneously find that middleware is not a reasonable substitute and that Microsoft's exclusionary conduct contributed to the maintenance of monopoly power in the operating system market. Microsoft claims that the first finding depended on the court's view that middleware does not pose a serious threat to Windows, see supra Section II.A, while the second finding required the court to find that Navigator and Java would have developed into serious enough cross-platform threats to erode the applications barrier to entry. We disagree. {78-79}

[T]he question in this case is not whether Java or Navigator 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}

As to the first, suffice it to say that it would be inimical to the purpose of the Sherman Act to allow monopolists free reign to squash nascent, albeit unproven, competitors at will—particularly in industries marked by rapid technological advance and frequent paradigm shifts. Findings of Fact ¶ ¶ 59-60. As to the second, the District Court made ample findings that both Navigator and Java showed potential as middleware platform threats. {79}

[...]

III. ATTEMPTED MONOPOLIZATION

[...]

IV. TYING

[...]

V. TRIAL PROCEEDINGS AND REMEDY

[...]

VI. JUDICIAL MISCONDUCT

[...]

VII. CONCLUSION

The judgment of the District Court is affirmed in part, reversed in part, and remanded in part. We vacate in full the Final Judgment embodying the remedial order, and remand the case to the District Court for reassignment to a different trial judge for further proceedings consistent with this opinion. {119}