Why the Microsoft Settlement Won't Work

There's still not much to restrain it from engaging in anticompetitive practices

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The Microsoft antitrust trial, probably the most important technology-related legal case of our time, appears to be limping at last toward a conclusion. Unfortunately, there is an excellent chance that the software colossus will win despite losing, without much to restrain it from going back to the heavy-handed, anticompetitive tactics that prompted the antitrust action in the first place.

Not just the competitors and would-be competitors of Microsoft Corp. will lose: you and I will, too. We will continue being denied innovations that only real and rigorous competition can bring. In many cases we won't know what we're missing, because one sorry effect of monopolistic domination is that many innovations do not even get the chance to be tested in the market.

Those of you who have lost track of the trial proceedings can be forgiven. The trial began five years ago as an action filed by the U.S. Department of Justice and 18 states and the District of Columbia. The suit's milestones include the April 2000 decision of U.S. District Court Judge Thomas Penfield Jackson, who found Microsoft had violated U.S. antitrust laws. Two months later, he ordered the company broken into two separate entities.

In June 2001, the U.S. Court of Appeals upheld Jackson's finding of violations. But it overturned Jackson's order, removed him from the case, and turned the proceedings over to Judge Colleen Kollar-Kotelly, of the U.S. District Court for the District of Columbia.

Last October, Judge Kollar-Kotelly ordered the Justice Department, Microsoft, and the states to negotiate a settlement. In November, Microsoft, Justice, and nine of the states agreed on terms to settle the case (the others are continuing the suit on their own). Under the settlement, Microsoft would not be split apart. Moreover, the restrictions that would be placed on the company are so riddled with loopholes that it is difficult to see how they could possibly rein in the company's entrenched anticompetitive behavior. At press time, observers were eagerly awaiting an announcement from Judge Kollar-Kotelly about whether she would accept the proposed settlement or would insist on more rigorous measures against the software giant.

As it stands, the proposed agreement offers plenty of opportunity for Microsoft to go on as it has. For example, one provision would permit users to choose non-Microsoft software as the default on their computers. Microsoft, however, can dictate that the software use Microsoft technologies. That caveat is just one of many in the settlement that would continue to block competitively innovative software.

Anyone who has followed Microsoft's history will have little doubt about whether the company will exploit these loopholes to continue bullying those who want to use or distribute its competitors' products. Microsoft's success in recent years has come from blocking users and developers from innovations by other companies that could threaten Microsoft's dominance. That is the essence of the company's violation of the antitrust laws, and its bad effects continue to the present day.

Web-browsing technologies are just one example. Countless memos show that in the 1990s Microsoft's senior executives saw Internet innovation, especially so-called middleware technologies that link the PC to the Web, as a threat to their monopoly position in Windows. From 1995 until the end of the browser war, they were particularly worried about losing user and developer attention to Netscape Communications' Navigator browser, to Sun Microsystems' Java architecture, and to other new Internet-related technologies.

Microsoft came out with its own browser, Internet Explorer, in 1995, to compete with Netscape. But Explorer's merits were not enough by themselves to persuade people to choose it.

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That may surprise you, but there was never any doubt about it inside Microsoft. Many internal memos and e-mails, over the entire period of the browser war, explain convincingly how and why Netscape was going to win. The fundamental reason was that Netscape had too much of a head start.

So to hang on to their supremacy, Microsoft executives adapted classic monopolistic tactics to the particular circumstances of the PC industry at the end of the 20th century. Basically, what they did was systematically block widespread distribution of superior new technologies and prevent third parties from collaborating with innovators.

They also warned original-equipment manufacturers (OEMs) away from Netscape Navigator by threatening to revoke their Windows license if they did not comply. They paid Internet service providers and firms like America Online to distribute only Internet Explorer because they were concerned they would "lose all those side-by-side user choices," according to Cameron Myhrvold, the product's own marketing manager.

When an OEM like Hewlett-Packard came up with valuable innovations that let users easily set up their own computers—and choose the browser they wanted—Microsoft banned them. Similarly, the company forced Intel to withdraw its support for Sun's Java, the original Java and a rival to Microsoft's version.

Through these tactics, and more, Microsoft forced developers of PC software to favor Internet Explorer if their software worked automatically with a browser, and to favor Microsoft's Java if their product linked to Java. Those were the tactics that drove the outcome of the browser and Java wars, which was (no surprise) a total victory all around for Microsoft.

The point of all this was to have the Windows monopoly survive competition "born on the Internet," as Bill Gates put it in 1995. Over a period of years, as Microsoft memos clearly show, executives concluded that the Internet threatened their monopoly position, and that they could not thwart it by producing better products. So they used unlawful tactics to keep customers from getting a chance to choose new technologies.

They also imposed what insiders called a "strategy tax" on their own browser developers—browser improvements that would benefit customers could nevertheless be nixed if they didn't improve the strategic position of Windows and Office, Microsoft's core products. With all of Microsoft's talent, it is not surprising that some of their own people complained bitterly about these tactics—they wanted to try to win on the merits of their creations rather than by brute force.

The damaging and distorting effects of those tactics harm computer users to this day. The Netscape browser, Java on PCs, and multimedia technologies from Intel have all disappeared from the marketplace. Indeed, Microsoft goes on blocking distribution of innovations by others, as documents introduced at the trials show. Examples include multimedia software from Real Networks and Nokia, as well as Nokia software to synch handheld data with your PC.

When efforts to prevent competition kill an innovative product or company, more than technology is lost. If Navigator, for instance, were still robust, middleware entrepreneurs would have two choices of distribution partner: Microsoft and Netscape. As a result, we have lost the opportunity even to consider new technologies not approved by Microsoft.

The bottom line is that, had Microsoft obeyed the law, we would have had much more innovation and competition over the last seven years. Moreover, much of that lost activity would have focused on the interface between the PC and the Internet—an area where more innovation would have been particularly welcome.

What next?

We need a remedy that will reopen the market to competition and innovation and give computer users and developers as much choice as they would have had without the violations. But the deal signed by Microsoft and the Department of Justice last winter won't do it. It is chockful of escape clauses and other ways for Microsoft to pressure third parties, squelch innovations from competitors, and block entrepreneurial startups from gaining access to your desktop.

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As for the states that are continuing the trial, they are now intent on forcing Microsoft to disclose technical information with which software developers could create products that work with Windows. They also want OEMs to have more flexibility and freedom from restrictive contracts and retaliation by Microsoft. Judge Kollar-Kotelly is considering these requests.

I particularly like an idea that those states have reluctantly forsaken: spinning off the Office software suite, including the Explorer browser, into a separate company. Only such a move would truly offer competitors to Windows an opportunity to enter and compete. For example, many more people would use the Linux operating system if it ran Office, especially an Office no longer subject to Microsoft's strategy tax. Meanwhile, middleware entrepreneurs could turn to the Office company as a distribution partner if the Windows company tried to block them. Consumers and developers would be given many more choices.

Sadly, it probably won't happen. And there aren't many options in between this sort of divestiture and a slap on the wrist. The most promising of those is compelling Microsoft to publish protocols (and the code that supports them) so that Internet software can work smoothly and transparently with Windows and Internet Explorer. The larger choice among innovations would leave users and developers worse off than if the lawbreaking had never happened, but better off than they are today. ●