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The Litigating States' Proposed Remedy For Microsoft

Antitrust as a Substitute for Competition

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Executive Summary

State officials face well-funded, well-organized coalitions of in-state businesses arguing for the prosecution of an out-of-state company—an unequal political contest. Accordingly, the state attorneys general (AGs) have resisted settlement attempts and have pushed both the Justice Department and the courts for stronger action against Microsoft. In the process, the interests of consumers—the AGs' nominal clients—have been paid little more than lip service.

The nine litigating states and the District of Columbia together account for just 27 percent of the U. S. population. But they do represent many of Microsoft's most vocal rivals. California is home to Apple, Palm, Oracle, Sun Microsystems, and Netscape. Massachusetts is home to the Lotus division of IBM as well as major operations of Sun and Oracle. Utah is home to Novell.

By far, the most overreaching provision in the litigating states' proposal is the prohibition on "binding" middleware code to Microsoft's operating system software. In short, the litigating states would require Microsoft to allow licensees to remove the software code for any function that a Windows licensee could conceivably single out, while still requiring Microsoft to maintain the performance of the operating system. If Microsoft were able to comply technically—which is far from clear—it would have to rewrite Windows from scratch as a combination of thousands of separable, modular components.

This would balkanize Windows as a platform for applications software. Developers would no longer be able to count on the presence of key segments of software code. Indeed, to ensure that their software worked properly, developers would have to provide those features themselves. As a result, consumers would encounter different flavors of Windows with differing capabilities.

Adding to Microsoft's (and consumers') woes, the litigating states would require Microsoft to license large amounts of its intellectual property to competitors for little or no compensation. Competitors would get Microsoft's software code for free. But consumers would suffer in the long term from decreased innovation since Microsoft would be left with little incentive to develop Windows or many of its applications programs.

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I. INTRODUCTION

Many of Microsoft's critics have derided the Revised Proposed Final Judgment put forth by the Department of Justice, nine of the original plaintiff states, and Microsoft as being too weak.[1] These critics say the remedy proposed by the remaining nine litigating states (plus the District of Columbia) would "restore" competition.

But a close look at the states' proposal leads to very different conclusions. I first examine the climate in which the antitrust proceedings are operating. Both theory and evidence suggest that what economists call "rent seeking"—the redistribution of property through non-market activity—is firmly entrenched in the landscape. I then analyze key provisions of the litigating states' remedy and find that the potential beneficiaries are Microsoft's rivals, not software consumers. For example, the sweeping intellectual property disclosures mandated by the litigating states' remedy would provide rivals with valuable proprietary information about Microsoft products at little to no cost. This would eliminate Microsoft's incentives to develop new products and new features for existing products, to the long-term detriment of consumers.

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[1] Elsewhere I analyze the settlement. See Robert W. Hahn, "United States v. Microsoft: The Benefits of Settling," Related Publications 02-02, January 2002 (forthcoming in *Regulation*). Available at http://www.aei.brookings.org/publications/related/settlement.pdf. Here I focus strictly on the Plaintiff's First Amended Proposed Final Judgment.

II. THE LEGAL PROCESS AS A POLITICAL TOOL

A. Political Motivations

A substantial academic literature suggests that antitrust policymaking and enforcement often serve narrow private agendas, rather than broad public ends.[2] According to this research, politicians are responsive to lobbyists because lobbyists represent interests that are more focused—and thus pressed more keenly—than consumer interests. At work are relatively small coalitions of producers (as compared to, say, consumers nationwide) with a "strong community of interests [who] tend to have stronger political voices because each group member has a larger financial stake in the outcome…"[3] On the other side of the equation is the reality that any costs imposed on the nation as a whole will be widely spread—and therefore will not be as damaging to the politician as the cost of refusing to help the well-organized special interests.[4]

It is hardly surprising then, that Microsoft's rivals have moved aggressively to influence both the prosecution of the case and the nature of the remedies imposed.[5] Many of Microsoft's most ardent opponents have a great deal to gain by hobbling it with continual litigation and draconian remedies. State officials thus face well-funded, well-organized coalitions of in-state businesses arguing for the prosecution of an out-of-state company—an unequal political contest.[6] Accordingly, the state attorneys general have resisted settlement attempts and have

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[2] See, generally, the collection of articles in Fred S. McChesney and William F. Shughart II, eds., *The Causes and Consequences of Antitrust, The Public-Choice Perspective*, University of Chicago Press, 1995. See also, George J. Stigler, "The Theory of Economic Regulation", *Bell Journal of Economics*, 1971.

[3] William F. Shughart II, "Public-Choice Theory and Antitrust Policy," in *The Causes and Consequences*, at 13. See also Mancur Olson, *The Logic of Collective Action: Public Goods and the Theory of Groups*, Harvard University Press, Cambridge, Mass., 1971.

[4] As Judge Richard Posner noted, due to geographic concentrations of companies within a state, the potential exists to exercise "a great deal of power to advance the interest of businesses located in [a Congressman's] district however unimportant the interests may be from a national standpoint." Richard Posner, "The Federal Trade Commission," *The University of Chicago Law Review* 37, at 87.

[5] This is a natural, but unfortunate outcome of the incentives of the current system. In its early years, Microsoft paid little or no attention to politics. But, after years of antitrust accusations, the company has learned to play the game as well.

[6] The settling states are not immune to this type of pressure, either. Indeed, in all likelihood, the settling states chose to accept the settlement for equally parochial reasons. That explains in part why Judge Richard Posner argues that states should be excluded from federal antitrust actions. See Richard A. Posner, "Antitrust in the New Economy," *Antitrust Law Journal* issue 3, 2001.

pushed both the Justice Department and the courts for stronger action against Microsoft. In the process, the interests of consumers—the nominal clients of the attorneys general—have been paid little more than lip service.

Microsoft's competitors have been wielding the antitrust weapon for many years. At least as far back as 1993, Novell, a major producer of networking software, urged the Federal Trade Commission (FTC) to pursue an antitrust case against Microsoft.[7] And when the FTC decided to suspend its investigation, Novell, Lotus and WordPerfect lobbied the Department of Justice to pick up where the FTC left off.[8] More recently, Microsoft rivals have increased their visibility in Washington and dramatically increased their lobbying expenditures.[9] For example, in 1998, Sun underwrote the $3 million cost of a team of legal and economic experts given the task of persuading the Department of Justice to bring an antitrust case against Microsoft.[10]

Officials at the Justice Department have recently complained about this very process. Deborah Majoras, Deputy Assistant Attorney General for Antitrust, "decried what she called the 'strategic use' of antitrust suits by companies to hurt competitors."[11] Majoras went on to note that one lobbyist for a Microsoft competitor "threatened that if I did not do as his client wished, I could count on the fact that I would never again get any more help in Silicon Valley in any investigation in the future."[12]

California, which is home to many of Microsoft's fiercest rivals, has seen especially aggressive lobbying on the part of Microsoft's competitors. Indeed, the idea that it is the

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[7] "Novell has reportedly been quietly lobbying the FTC to act against Microsoft while also soliciting support in the industry for a class-action suit should the FTC fail to act." Christopher Lindquist, "FTC Decides Not to Decide [Yet]," *ComputerWorld*, July 26, 1993, at 4. See also Julie Pitta, "Microsoft's Dark Shadow," *Forbes*, March 1, 1993, at 106-107.

[8] Richard McKenzie, *Trust on Trial*, Cambridge: Perseus Publishing, 2000, at 197-198.

[9] John Heilemann, *Pride Before the Fall*, New York: HarperCollins, 2001, at 76.

[10] Heilemann, at 88-94.

[11] Mark Wigfield, "DOJ Atty Decries Companies' Politicization of Antitrust," Dow Jones News Service, February 2, 2002. Assistant Attorney General for Antitrust Charles James echoed this concern: "Indeed, the number of requests for meetings with me immediately after my nomination but before my confirmation became so daunting that I adopted the posture of refusing to meet personally with any third parties in the *Microsoft* case…" Charles James, "The Real *Microsoft* Case and Settlement," *Antitrust* vol. 16, no. 1, Fall 2001, at footnote 16.

[12] Wigfield (2002).

government's job to serve its corporate constituents is so ingrained that elected officials don't go through the trouble of concealing their complicity. A story published shortly after California and several other states decided not to accept the settlement reported that California Attorney General Lockyer said "his resolve was hardened after listening over the weekend to advice from technical experts and officials from Microsoft's competitors, such as IBM, AOL Time Warner Inc., Sun Microsystems Inc. and Novell Inc."[13] The State of California has subsequently taken the lead in the continuing litigation, in particular by providing funding. As one press account confirmed, "Microsoft's competitors lobbied California lawmakers and Governor Gray Davis to approve the extra $3.7 million for antitrust enforcement…"[14]

These same competitors have also actively opposed the settlement by filing comments in the Tunney Act proceedings in which the judge is required to weigh the merits of antitrust settlements in terms of the broader public interest. AOL, Novell, Palm, RealNetworks, SBC and Sun Microsystems have all filed Tunney Act comments.[15] Trade groups supported by many of Microsoft's biggest rivals have also actively opposed the settlement and filed motions asking for permission to participate in the hearings.[16] In particular, the Computer and Communications Industry Association (CCIA) and the Project to Promote Competition & Innovation in the Digital Age (ProComp) have been busy beating the war drums.[17]

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[13] Ted Bridis, "Many of 18 states prepare to reject antitrust settlement with Microsoft," *Associated Press*, November 6, 2001. See also Mary Ann Ostrom, "California attorney general takes high profile against Microsoft," *San Jose Mercury News*, November 7, 2001.

[14] Ted Bridis, "States Vow to Fight Microsoft," *Associated Press*, November 9, 2001.

[15] The U.S. Department of Justice has posted "major" comments on the proposed settlement; links for these are provided at http://www.usdoj.gov/atr/cases/ms-major.htm. Direct competitors submitting "major" comments include: AOL Time Warner, Red Hat, RealNetworks, SBC, Novell, Palm and Sun Microsystems.

[16] Trade associations supportive of Microsoft, such as the Association for Competitive Technology (ACT), filed comments as well. See http://www.usdoj.gov/atr/cases/ms_tuncom/major/mtc-00027806.htm.

[17] "CCIA Seeks to Intervene in Microsoft Settlement Hearing," Computer & Communications Industry Association, February 8, 2002, available at http://www.ccianet.org/press/02/0208.php3; "ProComp Files Motion Asking to Participate in Tunney Act Proceedings," Project to Promote Competition & Innovation in the Digital Age (ProComp), February 8, 2002, available at http://www.procompetition.org/headlines/020802.html. Computer & Communications Industry Association (CCIA), another lobbying association that receives major funding from Microsoft competitors including Sun and Oracle, also filed a comment. See "Comments of Computer & Communications Industry Association on the Revised Proposed Final Judgment," Computer & Communications Industry Association, January 28, 2002 available at http://www.ccianet.org/legal/ms/tunney/ccia.pdf; "Comments to the Proposed Final Judgment," Project to

B. Private Uses

Companies do not restrict their rent-seeking behavior to the political arena. Private lawsuits, or even just the threat of them, can be used as bargaining chips in business negotiations. For example, America Online (AOL) recently filed a lawsuit against Microsoft for alleged damages resulting from the actions Microsoft took against Netscape (later acquired by AOL for $10 billion) that were found to be anticompetitive by the courts. As a *Wall Street Journal* article observed, "The Netscape lawsuit is just the latest move in a bigger chess match between AOL and Microsoft."[18] AOL is the world's largest Internet access provider and has an extensive proprietary online network that competes directly with Microsoft's MSN Internet service. "AOL had been holding out the prospect of a lawsuit as a threat against Microsoft as the two companies negotiated last spring," the *Journal* story noted.[19]

III. THE LITIGATING STATES' PROPOSED REMEDY—TAILORED FOR MICROSOFT'S COMPETITORS

The litigating states represent the powerful rivals of Microsoft with major operations within the states' boundaries. And by no coincidence, their proposal neatly dovetails with the business needs of Microsoft's competitors.

Promote Competition & Innovation in the Digital Age (ProComp), January 28, 2002, available at http://www.procompetition.org/headlines/012802.pdf. Progress & Freedom Foundation, a think-tank that receives funding from (among others) Sun, Novell, Oracle, IBM, and SBC filed a comment as well; see http://www.pff.org/supporters.htm.

[18] Julia Angwin and Jared Sandberg, "Lawsuit Against Microsoft Is Netscape's Biggest Asset," *The Wall Street Journal Online*, January 24, 2002.

[19] Angwin and Sandberg (2002).

A. A Profile of the Litigating States

The Department of Justice, which represents all Americans, along with nine states have chosen to settle the case.[20] Two other states dropped out of the litigation or settled earlier.[21] Another thirty never participated in the litigation at all. Meanwhile, the nine litigating states[22] and the District of Columbia together account for just 27 percent of the United States' population.[23]

But the litigating states do represent many of Microsoft's most vocal rivals. California is home to Apple, Palm, Oracle, Sun Microsystems, and Netscape (although Netscape is now part of AOL Time Warner, based in New York). Massachusetts is home to the Lotus division of IBM as well as major operations of Sun and Oracle. Utah is home to Novell.

B. How the Litigating States' Proposed Remedy Benefits Microsoft's Rivals

While much of the litigating states' remedy appears to be designed for the benefit of Microsoft's most ardent competitors without regard to the impact on consumers, I focus on a handful of particularly egregious requirements.

1. A Windowless World

By far, the most overreaching provision in the litigating states' proposal is the prohibition on the "binding" of "middleware" code to Microsoft's operating system software.[24]

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[20] The nine settling states are New York, Ohio, Illinois, Kentucky, Louisiana, Maryland, Michigan, North Carolina, and Wisconsin. Of course, these states do no better at representing national interests than the litigating states. They are likely to have their own parochial reasons for settling.

[21] Two other states were party to the initial complaint, but South Carolina withdrew from the suit in December 1998 after AOL announced that it was purchasing Netscape and New Mexico reached an independent settlement with Microsoft in July 2001.

[22] The nine litigating states are California, Connecticut, Florida, Iowa, Kansas, Massachusetts, Minnesota, Utah, and West Virginia. The District of Columbia joined these states in pursuing litigation.

[23] U.S. Census Bureau, Census 2000 Redistricting Data (P.L. 94-171) Summary File. All but two of the litigating states, Kansas and Utah, have Democratic attorneys general; see National Association of Attorneys General, available at http://www.naag.org/ag/full_ag_table.cfm.

[24] Plaintiff's First Amended Proposed Final Judgment (referred to as Plaintiff's proposal henceforth), at 2. I rely on the litigating states' definition of the term "middleware" (as well their definitions for other products, such as "browser") throughout this paper.

In short, the litigating states would require Microsoft to allow licensees to remove the software code for any middleware they could conceivably single out, while still requiring Microsoft to maintain the performance of the operating system. Because the litigating states define middleware to include almost all kinds of software,[25] this provision would go well beyond including Add/Remove buttons for the limited middleware at issue in the trial and would require a complete redesign of Windows. If Microsoft were able to comply technically, which is unclear, it would have to rewrite the Windows operating system from scratch as a combination of thousands of separable, modular components.[26] Licensees could then offer various versions of "Windows" by excluding different combinations of these modules at will.[27]

Licensees could potentially offer hundreds, if not thousands, of versions of Microsoft's PC operating system, each with a different combination of "middleware" excluded but all marketed as "Windows."[28] This would fragment the Windows platform. Developers would no longer be able to count on the presence of key segments of software code (application programming interfaces, or APIs) used by their programs. Indeed, to ensure that their software

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[25] The litigating states' definition of middleware is quite broad, covering "without limitation Internet browsers, network operating systems, e-mail client software, media creation, delivery and playback software, instant messaging software, voice recognition software, digital imaging software, the Java Virtual Machine, calendaring systems, Handheld Computing Device synchronization software, directories, and directory services and management software." Plaintiff's proposal, at 24.

[26] Designing any modern operating system with millions of lines of code, let alone a new modular operating system, is extremely difficult and costly to do. It certainly could not be done in the six months allowed by the litigating states, and could conceivably take years to accomplish—even starting from the current Windows code. The resulting modular operating system would likely contain a great deal of redundant code since each module would have to be self-sufficient and completely removable. The litigating states do allow for an extension to the 6-month timeframe, but would require their decree be extended by the same increment. If Microsoft required five years to redesign Windows, the litigating states remedy would have to be administered for 15 years.

[27] In addition to OEMs, all licensing, contract and negotiation rules would apply to "third-party licensees" offering to purchase and redistribute at least 10,000 licenses for a product or combination of products. This would include individuals, independent software vendors (ISVs), systems integrators, and value-added resellers. Therefore, any licensee ordering the minimum 10,000 copies would be able to dictate what middleware had to be removed from Windows. Plaintiff's proposal, at 26.

[28] Every one of these different versions of Windows could be marketed as "Windows" without distinguishing what pieces of code were missing. If a total of n middleware products were defined, then 2^n different versions of Windows could potentially be offered. Given the litigating states' remedy's expansive definition of "middleware," n could range from roughly 10 (interpreting the definitions narrowly) to thousands (treating every Windows API as a separate piece of "middleware"). For n=10, the required number of Windows versions (for each of Windows Me, Windows 2000 Professional, Windows XP Home, and Windows XP Professional) would be 1,024.

worked properly, developers would have to provide those features themselves (raising their own costs). Alternatively, developers could obtain the source code supporting those APIs and distribute it separately for consumers to install as needed. As a result, consumers would encounter different flavors of Windows with differing capabilities.

The ensuing confusion would surely increase support costs for Microsoft, other software developers, and computer manufacturers. Added to every support call would be numerous questions to determine which version of Windows was installed on the computer. Thus, the litigating states' provision would allow rivals to impose high costs on Microsoft[29]—with software developers and consumers absorbing the collateral damage.

The litigating states' remedy would also micromanage Microsoft's pricing decisions in an unprecedented way. Each less-than-full version of Windows would have to be licensed at a reduced price, where the discount was determined by the relative "development costs" of the omitted Microsoft middleware.[30] If a Microsoft programmer had a flash of inspiration and invented valuable new middleware for Windows in just a few days, Microsoft's discount for omitting that middleware would be negligible. If another feature, less valuable to consumers but still deemed worthy of investment, took months to develop, its discount would be much higher. The remedy would require that discounts be based on the cost of inputs alone—and would thus not be influenced by market demand, which ordinarily leads market prices to reflect value to consumers.

Ignore for a moment, however, the lack of economic foundation for the litigating states' pricing provision and consider how difficult it would be to implement. Design teams often develop software components simultaneously, making it impossible to calculate discrete

[29] A competitor, such as Sun, could license 10,000 copies of Windows for "internal use" in order to mandate that obscure pieces of middleware were removable from the operating system. At trial, a number of different prices were used as "representative" of the price of Windows to OEMs. At an average price of $65, Sun or other Microsoft competitors could force Microsoft to incur many millions (perhaps billions) of dollars in development and testing costs—all for an outlay of less than $1,000,000. As noted above, Sun spent three times that amount in convincing the DOJ to bring charges against Microsoft. This illustrates competitors' willingness to incur costs in order to raise Microsoft's expenses.

[30] The maximum total discount would be 25 percent, unless Microsoft offered the middleware for sale separately, such as for use by customers who obtain a version of Windows that omits it. In that case, the discount would be determined by the separate distribution "price" and would not be limited to 25 percent. Plaintiff's proposal, at 3.

development costs for individual components. The costs necessarily would be allocated in an arbitrary manner—with each licensee arguing that more costs be allocated to the functions it wanted to exclude.

It is easy to imagine cases where the pricing provision would prevent Microsoft from competing. Any new feature or enhancement could be defined as middleware and thus would fall under the provision. For example, the version of Windows containing Windows Messenger would have to be priced higher than the base version. But AOL could still give away its competing Instant Messenger, the leading instant messaging software. Similarly, Microsoft would have to charge extra if Media Player were included with Windows, but RealNetworks could continue to give away versions of its RealPlayer in order to maintain its market leadership.

In the highly competitive market for software that runs server networks, which is also covered by the litigating states' proposed remedy, Microsoft would be forced to charge separately for the networking components of the "client" operating systems on computers accessing the network. Novell and Sun, by contrast, would remain free to provide client computer software that connected to their server software at prices that undercut the formulaic prices Microsoft had to charge.

In fact, if Microsoft anticipates a competitor offering a new piece of middleware (network-based or PC-based), Microsoft would have no incentive to develop it because the company likely would be at a competitive disadvantage in product pricing. As a result, the litigating states' pricing provision would weaken the competition that market leaders AOL, Sun, and RealNetworks face from Microsoft, giving them greater discretion to raise prices to consumers.

Thus, any reasonable reading of the binding and pricing provisions leads to the conclusion that the litigating states' remedy would mean less competition—and considerable harm to consumers. First, it seems unlikely that Microsoft could comply with the provisions within the allotted six months. Even if it could, the provisions remove Microsoft's incentives to make the transition because the company would not be permitted to sell the software at

competitive prices. Consumers could easily encounter higher prices since competitors would face decreased price pressure from Microsoft.[31]

2. Intellectual Property Giveaways

Adding to Microsoft's (and consumers') woes, the litigating states would require Microsoft to license large amounts of valuable intellectual property (IP) to competitors for little or no compensation.[32] Competitors would get Microsoft's software code for free, but consumers would suffer in the long term from decreased innovation since Microsoft would be left with little incentive to develop Windows or many of its applications programs.

Under the litigating states' proposed remedy, Microsoft would have to auction the right to adapt its Office business applications suite to non-Windows operating systems in exchange for one-time payments.[33] The auction winners would not incur any of the original development costs associated with creating and enhancing Office; they would face only the costs of adapting the software to a new platform, such as Linux. As a result, they could profitably license the new Office suite for bargain prices. Moreover, since the auction winners could face stiff competition among themselves, the auction prices paid to Microsoft would likely be modest. Microsoft would also lose a distinguishing feature for the Windows platform. All of this would make it highly unlikely that Microsoft received full compensation for its intellectual property or lost sales of Windows.

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[31] Plaintiff states might argue that new or existing competitors would step in to replace Microsoft, but this process would take considerable time and involve significant transition costs. And there would be no guarantee that consumers would pay lower prices in the end.

[32] This paper covers just a few examples of the IP giveaway requirements in the litigating states' remedy. Still another provision calls for Microsoft to license "all intellectual property rights … that are required to exercise any of the options or alternatives provided or available to them under this Final Judgment." Plaintiff's proposal, at 11. Plus Microsoft would have to disclose "all APIs, Technical Information and Communications Interfaces" needed to permit rival middleware to achieve "interoperability" with Microsoft software. Plaintiff's proposal, at 6. Microsoft would also have to allow "qualified representatives of OEMs, ISVs, IHVs [independent hardware vendors], IAPs, ICPs [Internet content providers], and Third-Party Licensees" to "study, interrogate and interact with the source code and any related documentation and testing suites of Microsoft Platform Software." Plaintiff's proposal, at 7. Microsoft Platform Software is defined as operating systems and middleware, so it would seem to encompass all of Microsoft's major products.

[33] Auction winners would not be allowed to adapt Office to the Macintosh platform either. Plaintiff's proposal, at 11.

As part of this mandate, Microsoft would have to provide all relevant source code for both the Macintosh and Windows versions of Office (which are different products based on unrelated source code) as well as "all parts of the source code of the Windows Operating System Product necessary for the porting."[34] Any new versions of Office, plus all new "necessary" Windows source code, would also have to be passed on to the auction winners, for no additional charge. So, in addition to not receiving full compensation for past Office development efforts, Microsoft would receive no compensation for ongoing development efforts.

Yet another provision of the litigating states' proposal would require Microsoft to release its browsers (Internet Explorer and MSN Explorer) under "open source" licenses.[35] That is, Microsoft would have to release all of the browser source code to the general public (not just to three auction winners as with Office) for use, modification and redistribution. And it would have to do so for free.

Thus, under the litigating states' remedy, Microsoft's competitors stand to gain a great deal of intellectual property at little to no cost. Any rival wishing to clone Windows or to improve another operating system could cherry-pick the technology included in Internet Explorer (IE) and MSN Explorer. Sun Microsystems could use the disclosure provisions to gain access to everything it needed to copy key Windows features for its server operating system, Solaris. Oracle, IBM and Novell, all of which compete with Microsoft in email software, would be in the same enviable position. They could learn how Microsoft's email software, the MS Exchange Server, replicates and communicates, significantly lowering the costs of cloning Exchange. The result would be a grand-scale expropriation of Microsoft's intellectual property.

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[34] Plaintiff's proposal, at 11.

[35] Plaintiff's proposal, at 9. Along with the requirement to give away source code, Microsoft would also have to expend resources to assist competitors in understanding the source code with the goal of modifying it. Even ardent supporters of open-source software find fault with this provision. For example, Lawrence Lessig, a professor at Stanford Law School writes: "While I am a strong supporter of the free and open source software movements …I am not convinced the requirement of open sourcing Internet Explorer is yet required, or even effective." Lessig argues that the DOJ settlement already has "a strong requirement that application interfaces be disclosed, and until that remedy proves incomplete, I don't believe the much more extreme requirement of full disclosure of source code is merited." Testimony of Professor Lawrence Lessig, Stanford Law School,

The intellectual property freebies would be even more helpful to competitors in combination with the binding and pricing provisions. Consider that Microsoft would have to give away its browsers as open source software. At the same time, Microsoft would have to charge a higher price for any version of Windows containing IE, as compared to the versions without it. Because they could not guarantee its presence, Microsoft could not even tout IE as a feature that enhanced Windows. On the other hand, AOL would remain free to pay computer makers not to install any Microsoft browser software (IE or MSN Explorer) and to feature the AOL browser (a customized version of IE). By knocking Microsoft out as a competitor in this fashion, AOL could more easily maintain its dominance in Internet access and instant messaging. Under these circumstances, few computer makers would distribute Internet Explorer and none would ever pay for it.

In fact, virtually all of the IP disclosure rules proposed by the litigating states are designed in a way that guarantees Microsoft could not recoup the value of past R&D investments through licensing. To name a just few such examples: IE and MSN Explorer would be provided for free; the Office auction would only allow for a one-time payment with no ongoing royalties; all new Office enhancements would be given to the auction winners for free; large amounts of Windows source code would be shown to competitors for free. The initial effect of disclosing an innovation after it has been developed is necessarily positive for consumers, who need not compensate the innovator to get the benefit. But the long-term effects are decidedly negative: knowing that it will not retain the rights to the IP it develops and will not receive compensation for the expropriation, a firm has no incentive to invest in further development.

The end-result of the litigating states' proposal, then, would be the elimination of Microsoft's incentives to invest in software development. Giving away the source code would kill further improvement in Microsoft's browsers. Licensing Office for fire-sale prices and providing all later Office enhancements for free would erase any incentive to continue

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before the Senate Committee on the Judiciary at its hearing: The Microsoft Settlement: A Look to the Future, December 12, 2001.

developing Office. Opening Windows source code to competitors would destroy Microsoft's incentives to improve its operating system.

In each case, consumers would suffer in the long run. IE and MSN Explorer would languish; Windows would stagnate. Overall innovation by competitors might be reduced as well, since they would no longer face competitive pressure from Microsoft.

3. Other Gifts for Microsoft's Competitors

The prohibition on software "binding," the pricing limitations divorced from any economic principle, and the free-for-competitors intellectual property disclosure rules stand out as blatant attempts to help Microsoft's rivals at the company's expense. A couple of other provisions, minor only by comparison, warrant mentioning because they are so obviously aimed at rent seeking.

a. A Sun Monopoly in Java

Microsoft would be required to distribute, free of charge, a version of the "Java runtime environment" that is "compliant with the latest Sun Microsystems Technologies Compatibility Kit" with each and every copy of Windows and IE.[36] Note that, as part of the settlement for an earlier suit brought by Sun, Microsoft had already agreed to cease developing its own version of Java and eventually to stop distributing its version altogether.[37] Sun would be the sole beneficiary, gaining wide distribution of its own version of Java.[38] The result would be government-mandated control of this form of middleware for Sun.

Consumers, however, would gain nothing. Computer manufacturers are already at liberty to contract with Sun or any other supplier to install any Java runtime environment they or their customers desire. And Java is widely available through free Internet downloads.

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[36] Plaintiff's proposal, at 10.

[37] Settlement Agreement and Mutual Limited Release, Sun Microsystems v. Microsoft, No. C 97-20884 RMW, January 2001, available at www.microsoft.com/presspass/java/01-23settlement.asp.

[38] Note that Sun has not had Java approved by any industry standards organization.

b. An Invitation to Litigate

As a final example of naked rent seeking, consider how enforcement would work in the litigating states' plan. The remedy calls for a court-appointed Special Master who would have "access to all information, personnel, systems, equipment, premises and facilities" deemed "relevant." Microsoft competitors could use the fruits of these unlimited searches in formal hearings and investigations, which is likely to lead to a steady stream of filings. What is more, third-party complainants would be allowed to remain anonymous, making it almost costless for competitors to flood the regulator with complaints.[39]

Any number of Microsoft rivals would benefit from this provision because of its potential to raise Microsoft's costs. Consumers, however, could suffer as Microsoft was forced to divert resources from product development and support in order to fend off new charges.

IV. CONCLUSIONS

This analysis highlights numerous examples in which Microsoft's competitors, not competition itself, would benefit from the litigating states' proposed remedy. In addition to handing rivals large amounts of Microsoft's intellectual property for little or no compensation and increasing Microsoft's costs of doing business, the most egregious provisions would render ongoing development of Windows unprofitable. Rather than "restoring" competition, the litigating states' proposal amounts to a classic exercise in rent seeking: Microsoft's competitors are attempting to use the antitrust process to further their own interests at Microsoft's expense, with consumers bearing much of the cost.

[39] Nor would the charges have to have any real merit, as the Special Master would have only two weeks to determine whether to investigate.