

MICROSOFT VS. UNITED STATES (1998)

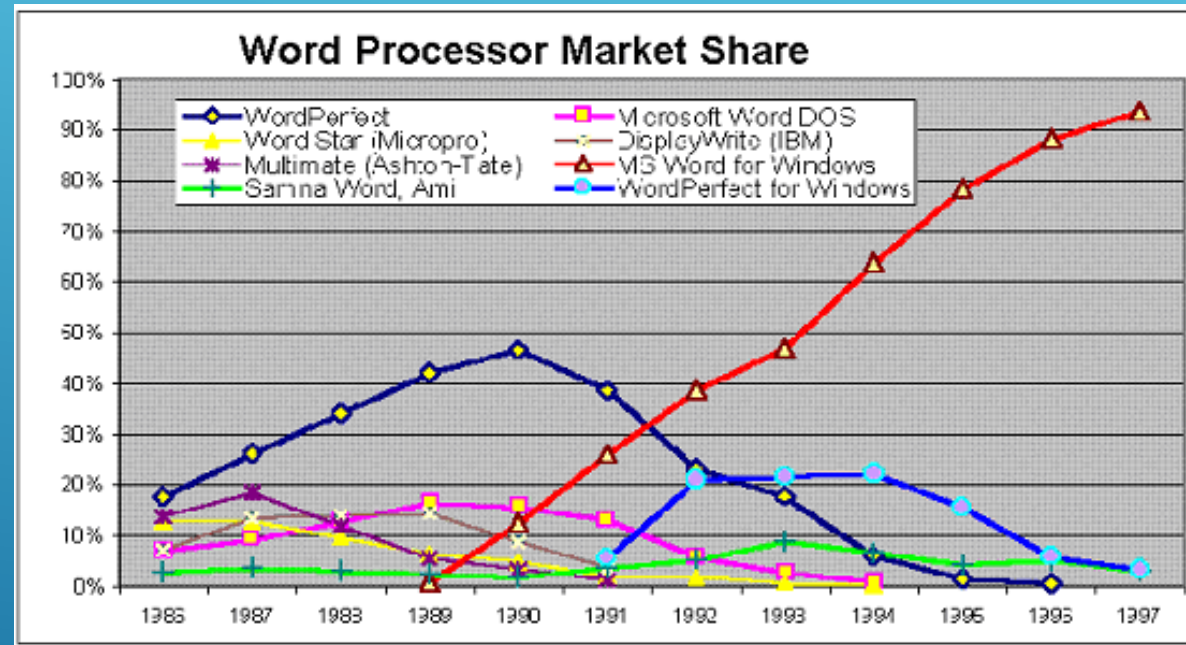
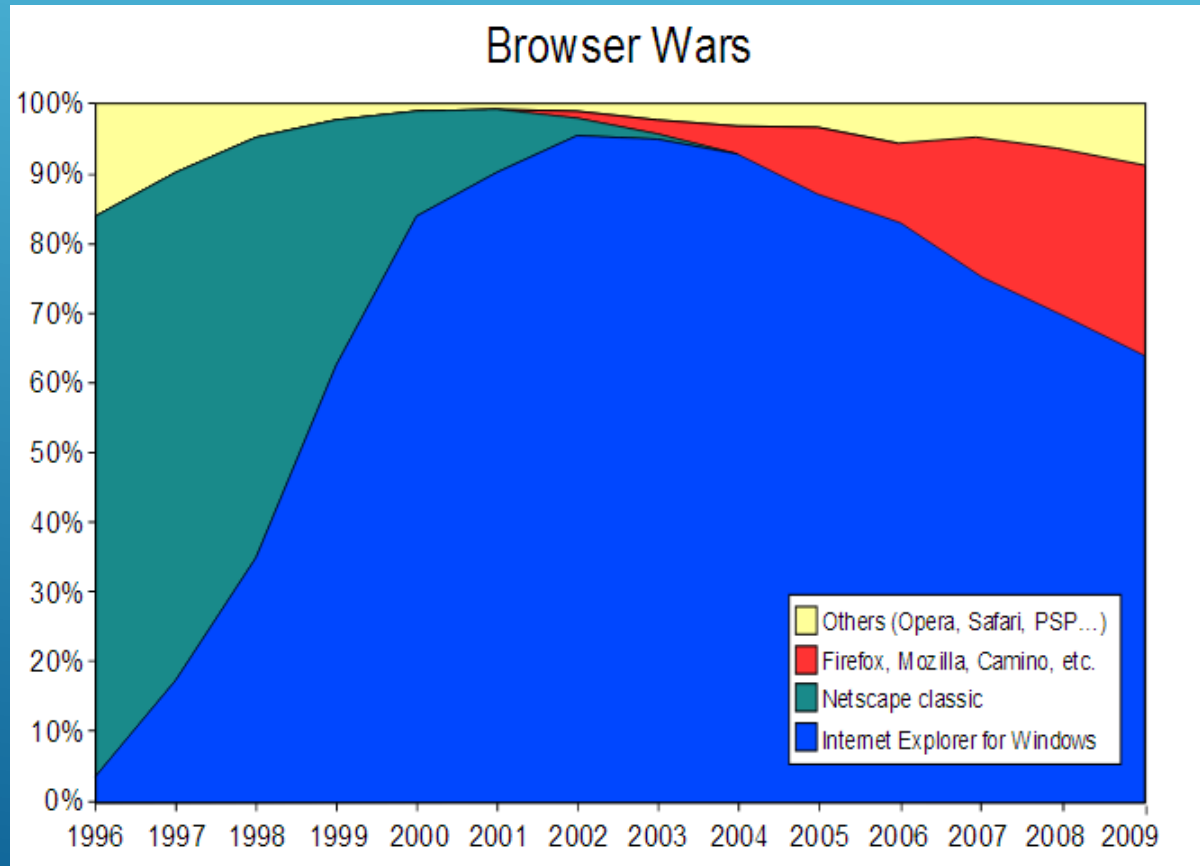
By Albert Koy

COMPANY HISTORY

- ▶ Microsoft was founded by Bill Gates and Paul Allen in 1975
- ▶ MS-DOS operating system was released in 1981
- ▶ Microsoft Windows was born after several iterations of MS-DOS. It gained 90-95% market share in the 1990s
- ▶ Before the trial, Microsoft was beginning to enter the market for software applications by releasing Microsoft Office and Internet Explorer



COMPETITIVE LANDSCAPE



MICROSOFT'S STRATEGY

- ▶ Microsoft's biggest asset in the 1990s was Microsoft Windows' market share, and Microsoft's main strategy was to leverage its market share.
- ▶ Microsoft started entering into exclusive contracts with computer manufacturers.
- ▶ Microsoft began bundling software like Internet Explorer into the Windows operating system.



ANTITRUST ALLEGATIONS

- ▶ Exclusive agreements and contract restrictions with computer manufacturers were anticompetitive
- ▶ Microsoft's exclusive access to Windows APIs was an unfair advantage
- ▶ Bundling was seen as an abuse of market power
- ▶ These allegations prompted the Microsoft vs. United States Antitrust Case of 1998



ITEMS OF DISPUTE

The Department of Justice proposed several means of reducing Microsoft's market power:

- ▶ Breakup of Microsoft
- ▶ Ban exclusive agreements and contract restrictions with computer manufacturers
- ▶ Ban bundling of products with Microsoft Windows
- ▶ Require Microsoft to disclose source code for Microsoft Windows
- ▶ Create a panel for enforcement of settlement results

BREAKUP OF MICROSOFT

- ▶ The DOJ wanted to break up Microsoft into two companies: an “operating systems” company and an “applications company”
- ▶ For the DOJ, by far the most radical solution. Microsoft’s market power could be reduced with less intervention.
- ▶ For Microsoft, clearly the worst-case scenario. Steve Ballmer stated that if this were to happen, it “would be utterly irresponsible”.

Department of Justice: 10

Microsoft: 40

BAN ON EXCLUSIVE AGREEMENTS AND CONTRACT RESTRICTIONS

- ▶ For the Department of Justice, the main fear was that Microsoft, being the main provider of operating systems, would be able to push around OEMs with unfair pricing agreements or other restrictions.
- ▶ On the other hand, Microsoft viewed the contracts as a way to increase market share. But, at this point in time, Microsoft already had over 90% market share.

Department of Justice: 35

Microsoft: 5

BAN ON BUNDLING OF PRODUCTS WITH WINDOWS

- ▶ To the Department of Justice, this was less important because it was merely a symptom rather than a cause of Microsoft having great market power.
- ▶ For Microsoft, bundling was an issue of lesser importance as well, but it was still a very useful strategy.

Department of Justice: 10

Microsoft: 15

DISCLOSURE OF SOURCE CODE

- ▶ The DOJ was initially interested in Microsoft opening up its APIs, but went a step further to suggest a wide disclosure of source code for Microsoft products.
- ▶ Selectively disclosing APIs and source code to developers was one way the DOJ asserted Microsoft's practices were anticompetitive.
- ▶ Microsoft placed great value on keeping its source code private because it was one of Microsoft's key competitive advantages.

Department of Justice: 25

Microsoft: 30

PANEL FOR ENFORCEMENT OF SETTLEMENT RESULTS

- ▶ Clearly, the Department of Justice had an interest in ensuring that Microsoft was complying with the terms of the settlement.
- ▶ On the other hand, it seemed that Microsoft would be willing to tolerate a layer of regulation within its company so long as it is kept intact, its source code was kept private, and strategies like bundling were still permitted.

Department of Justice: 20

Microsoft: 10

ADJUSTED WINNER METHOD

Item of Dispute	United States	Microsoft
Breakup of Microsoft	10	40
Ban on exclusive agreements and contract restrictions	35	5
Ban on bundling	10	15
Disclosure of source code	25	30
Panel for enforcement	20	10

ADJUSTED WINNER METHOD

After the first pass:

- ▶ **United States has:** Ban on exclusive agreements and contract restrictions (35), Panel for enforcement (20).
- ▶ **United States Total:** $35 + 20 = 55$ points
- ▶ **Microsoft has:** Breakup of Microsoft (40), Ban on bundling (15), Disclosure of source code (30)
- ▶ **Microsoft Total:** $40 + 15 + 30 = 85$ points

ADJUSTED WINNER METHOD

Splitting the “Disclosure of source code item” (we assume it is fluid):

$$55 + 25x = 85 - 30x$$

$$55x = 30$$

$$x = \frac{6}{11}$$

$$55 + 25\left(\frac{6}{11}\right) = 85 - 30\left(\frac{6}{11}\right) = 68 \frac{7}{11} \text{ points}$$

FINAL RESULTS

At the end of the Adjusted Winner Method, each party has $68\frac{7}{11}$ points and the allocation is the following:

- ▶ **United States has:** Ban on exclusive agreements and contract restrictions (35), Panel for enforcement (20), $\frac{6}{11}$ of Disclosure of source code ($13\frac{7}{11}$).
- ▶ **Microsoft has:** Breakup of Microsoft (40), Ban on bundling (15), $\frac{5}{11}$ of Disclosure of source code ($13\frac{7}{11}$).

ANALYSIS OF RESULTS

- ▶ The results of the Adjusted Winner Method were similar to the actual results of the settlement.
- ▶ The “ban on exclusive agreements and contract restrictions”, “breakup of Microsoft”, and “ban on bundling” items were each awarded to the party with the higher valuation without splitting as in the actual results.
- ▶ The split of the “disclosure of source code” item corresponds to a compromise that was made in the actual results that required Microsoft to only disclose its private APIs.
- ▶ However, for the “panel for enforcement” item, it seems like there was a compromise in the actual settlement, which wasn’t reflected in the Adjusted Winner Results.

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