Microsoft's Antitrust Woes

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PC users enamored of the Windows 95 operating system and application software such as Excel or PowerPoint may be given to wonder: Why is the Department of Justice Antitrust Division waging war against Microsoft? Is this any way to treat the company that (along with Intel) is chiefly responsible for the proliferation of powerful, yet economical, personal computers? The Redmond, Wash. software giant is alleged by antitrust authorities to have engaged in a wide range of unscrupulous business practices—practices that authorities say are designed to foreclose lucrative markets to rival software firms.

The most vociferous complaints about Microsoft can be heard in software industry hubs such as Mountain Valley, CA and Provo, Utah. In fact, the decision by Department of Justice to pursue Microsoft came in response to an intense lobbying campaign spearheaded by firms such as Netscape Communications, Sun Microsystems, and Novell. What is it specifically that Microsoft and its enigmatic Chairman Bill Gates have done to create so much angst in Silicon Valley? In comments to the press (and most recently, in a Senate Judiciary Committee hearing), rival software executives have portrayed Microsoft as a ruthless monopolist bent on leveraging its dominant position in operating systems to gain advantage in virtually all other segments of the industry.

Greater than 85 percent of all PCs shipped today come installed with a Windows operating system—a share sufficient to constitute an effective monopoly under standards delineated by the courts. Some readers may ask: isn’t monopolization illegal? The answer is yes—well, sort of. Monopolization is a felony under section 2 of the Sherman Antitrust Act. However, several legal defenses have proven effective in evading the statute. For example, Microsoft could (credibly, perhaps) claim that its dominance owed to “superior skill, foresight, and industry” as opposed to exclusionary or predatory tactics. One thing is for certain. The trustbusters can count on a protracted, complicated, and costly battle should they elect to pursue a section 2 suit against Microsoft. And, based on the legal precedents, the odds of obtaining a conviction are not good.

Until recently, a standard proviso of Microsoft licensing agreements required PC makers such as Compaq and Dell to pay a royalty each time a computer was shipped—even if it lacked a Windows operating system. By weakening the incentive of PC vendors to shift to substitute operating systems (such as OS2), the licensing agreement created what economists call “artificial barriers to entry.” Microsoft agreed to discontinue this practice under the terms of a 1995 consent decree signed with the Justice Department.
Interestingly, the 1995 settlement was initially rejected by Federal Judge Stanley Sporkin (a ruling that was overturned on appeal) because it failed to erect a “Chinese wall” between Microsoft’s operating system division and its software development operations. Sporkin feared that the sharing of technical information between divisions would give Microsoft’s in-house software engineers an unfair advantage in the rush to develop applications tailored to the latest vintage operating system. There is a recrudescence of worry on this point as Microsoft readies Windows 98 for release.

Now Justice Department Antitrust chief Joel Klein is charging that Microsoft violated the terms of the consent decree by “bundling” its internet browser software (Internet Explorer) with Windows 95. Justice Department officials allege that Microsoft is exploiting its operating system monopoly to foreclose the market for browser software—to the detriment of Netscape, among others. The practice of bundling is illegal under section 3 of the Clayton Act in the circumstance where it contributes to a “substantial lessening of competition.” Though Netscape retains a 60 percent share in the browser segment, Microsoft could nevertheless find itself vulnerable if a section 3 suit is brought. However, it will be incumbent upon those bringing suit to prove that the products being jointly sold are not “functionally integrated.” For example, auto makers bundle engines with cars—but what good is a car without an engine? As a corollary, what good is an engine without a car? Microsoft is proffering the argument that the car-engine analogy also fits for operating systems and browser software (I would point out that while browser software may be useless without an operating system, the reverse is not necessarily true).

A surprise announcement came on March 11 that the Justice Department will not oppose the bundling of Internet Explorer with Windows 98, so long as Microsoft is willing to issue an unbundled version. This would appear at first blush to be a capitulation by Klein. The announcement produced a virulent reaction in Redmond, though. Gates himself has stated he believes the internet is where the future lies. Microsoft is endeavoring to position itself to profit from the forthcoming explosion in internet commerce. A key aspect of their strategy entails metamorphosing the PC operating system from a unit that merely runs software loaded on a hard drive to one that also provides an on-ramp to the information highway. This is a frightening prospect for some, who ask: By integrating internet software into its operating system, will Microsoft in effect be establishing toll booths at entry points to the information superhighway?

The marketing of an unbundled version of Windows 98 would amount to a de facto admission by Microsoft that operating systems and application software are not functionally integrated products. This in turn would give the Justice Department a major tactical victory. So look for Microsoft to fight this battle tooth and nail.