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Unexpected Outcome

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Attacking Microsoft was counterproductive for the antitrust instigators

WHEN THE UNITED STATES DEPARTMENT OF JUSTICE filed its antitrust suit against the Microsoft Corp. on May 18, 1998, the action garnered thunderous applause from techies, editorialists and Microsoft competitors such as Sun, Oracle, Netscape, Novell and Apple. Now that the case has been litigated to an ambiguous conclusion, the applause and press coverage are gone. But the real outcome of the antitrust case of the century remains to be told. Not only has government failed in its mission of consumer protection, but, most curiously, the loudest corporate champions of the case appear to have shot themselves in the foot and their shareholders in the back.

Officially, the government won U.S. v. Microsoft. In April 2000, Judge Thomas Penfield Jackson found the company had violated the Sherman Act in three ways: by maintaining a monopoly over PC operating systems, by attempting to gain a monopoly over Internet browsers and by tying the purchase of its Windows operating system to its browser, Internet Explorer. Jackson decided to fix the illegal conduct by slicing the company in half -- one part to sell operating systems, the other, applications.

The D.C. Circuit Court of Appeals reversed Jackson's divestiture order in June 2001, overturning the District Court ruling that Microsoft attempted to monopolize browsers and ordering the question of illegal tying retried. But it let part of the key ruling stand, reversing Jackson's finding that Microsoft had maintained an illegal operating system monopoly only in part. In addition, Judge Jackson's conduct was admonished (he sneered at the defendant in bull sessions with author Ken Auletta during the trial) and the appeals court removed him from the case.

The retrial was avoided by a settlement. In November 2002, Judge Colleen Kollar-Kotelly accepted a deal that contains two basic remedies: Microsoft shall allow PC makers to mix and match software applications on Windows' start-up screens (so that, say, Dell may delete the Internet Explorer icon, replacing it with Netscape Navigator), and Microsoft must provide independent software developers with important Windows code, fostering rivalry in applications.

Winners and Losers

Headlines announcing last year's deal read, "Microsoft Wins." It was substantively, if not technically, correct. The government's case against Microsoft relied "almost exclusively on Microsoft's varied efforts to unseat Netscape Navigator as the preeminent Internet browser," as the appeals court noted. Microsoft's share of the browser market, about 40% when the case was filed five years ago, is over 90% today. Java, the middleware embedded in Netscape Navigator to "commoditize" the operating system, has faded as a competitive threat to Windows and is struggling to hold a niche.

Microsoft continues to face challenges from Linux (PC operating systems), from Palm OS (mobile computing device software) and from Opera and Mozilla (browserware). But by the market-share test -- determinative in the Department of Justice's monopoly analysis -- Microsoft lives a life free of competitive worry.

Consumer choices were greatly expanded, not by the antitrust remedy but by the "browser war" the

government lawyers sought to enjoin. The bundling of Windows and Internet Explorer, along with the aggressive entry and counter-moves by Netscape, produced a textbook episode of creative destruction. A mass market in e-commerce was created virtually overnight, an intensely productive social outcome that emerged because of competition for the market. This inspired Netscape to attack Microsoft's hegemony by embedding a Java platform with which to launch non-Microsoft applications, by distributing millions of free Navigator programs, by opening its source code and by numerous other stratagems in this winner-take-all battle. Then Microsoft responded with a jihad of its own to protect its PC dominance in the face of the Internet challenge.

Little in the antitrust settlement will, or should, undo this brutal rivalry, although by early July antitrust prosecutors were alleging that Microsoft may be violating the agreement.

Ups and Downs

The financial marketplace has rendered its own judgment about the Microsoft case. In research published in the Journal of Financial Economics (March 2000), we reported on the long investigation of Microsoft's competitive practices. In 54 discrete news events reported in The Wall Street Journal 1991 through 1997, victories and setbacks for antitrust authorities were associated with substantial losses and gains for Microsoft stock, just as would be expected. But other computer firms incurred substantial losses and gains in the same direction, the opposite of what would be expected if investors believed that the government's antitrust case would open doors to greater competitiveness and efficiency. Actions that should hurt Microsoft should help its competition. But financial markets perceived costs, not benefits, for the rest of the computer sector as a result of U.S. v. Microsoft.

The trend continued through the past five years. The Nasdaq index with Microsoft stock excluded went up and down in the same direction as Microsoft shares at key events in the case. Investors apparently believed that the intended beneficiaries of the government's case -- Microsoft customers such as Compaq, Dell, Gateway and CompUSA, as well as complementary suppliers such as Intel, AMD and Cisco -- were actually harmed by antitrust enforcement.

This perverse outcome is underscored by an even more curious result: The leading corporate champions of U.S. v. Microsoft (AOL, Apple, Novell, Oracle and Sun) also suffered negative equity returns on news of government success.

Developments in the product market extend the irony. Companies that didn't promote the antitrust case have provided Microsoft with more effective competition than have the crybabies who ran to Washington. Microsoft faces challenges from companies that have embraced Linux, among them Hewlett-Packard, Dell and IBM. They worked with Microsoft when it suited them, and went with a competing product when it did not.

Legal attacks on a competitor that backfire raise corporate-governance questions. Sun Microsystems funded the economic analysis that prompted the DOJ to file its case. Oracle paid private detectives to dig up dirt on Microsoft. Novell and AOL lobbied for antitrust authorities to prosecute the case. As Wall Street firms are dragged into court to defend their stock picks, what liability should be assessed to those managers who foisted this counterproductive litigation strategy on their own shareholders?

Corporate Responsibility

Slipshod internal controls contributed to both the inflating and bursting of the Internet bubble. Netscape founder Jim Clark recalled, after selling Netscape to AOL, that he needed "more marketing bulls--t! For a tiny company with modest but exploding revenues, what was the biggest marketing event of all?" The answer turned out to be going public.

When exponential earnings growth failed to materialize, one thing a billionaire CEO might tell

company owners is that Bill Gates isn't playing by the rules. Antitrust litigation against Microsoft dents your own share price, but that might be a small price to pay for a red herring that blinds board members and shareholders to fundamental problems with the underlying business model. AOL likes to blame Microsoft for its problems, but U.S. v. Microsoft does not seem to have been much of a solution. AOL shares tumbled nearly 80% after the antitrust suit was filed, even as Microsoft shareholders were seeing positive returns.

The whimper that has come of the antitrust trial of the century disappoints those who hailed the ambitious case filed five years ago. Though concluded in virtually record time for litigation of its size and scope, and with a legal judgment finding Microsoft in violation of our nation's competition policy, the software giant still purrs. More important, the evidence shows that what was good for the government's case was bad for consumers and even for shareholders in the very companies that sought antitrust litigation. On the far side of the dot-com financial bubble, our vision should be less clouded when observing what federal antitrust lawyers contribute to the technological upheavals driven by competition for the market.

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