

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

UNITED STATES OF AMERICA,)
)
 Plaintiff,)
)
 v.)
)
)
MICROSOFT CORPORATION,)
)
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 Defendant.)
)

Civil Action No. _____
Judge Charles R. Richey

COMPLAINT
(For Violations of Sections 1 & 2 of the Sherman Act)

The United States of America, acting under the direction of the Attorney General of the United States, brings this civil action to prevent and restrain the defendant Microsoft Corporation ("Microsoft") from using exclusionary and anticompetitive contracts to market its personal computer operating system software. By these contracts, Microsoft has unlawfully maintained its monopoly of personal computer ("PC") operating systems and has unreasonably restrained trade.

Virtually all major PC manufacturers find it necessary to offer Microsoft operating systems on most of their PCs. Microsoft's monopoly power allows it to induce these manufacturers to enter into anticompetitive, long-term licenses under which they must pay royalties to Microsoft not only when they sell PCs containing Microsoft's operating systems, but also when they sell PCs containing non-Microsoft operating systems.

These anticompetitive contracts help Microsoft maintain its dominance in the PC operating system market. By inhibiting competing operating systems' access to PC manufacturers, Microsoft's exclusionary contracts slow innovation and deprive consumers of an effective choice among competing PC operating systems.

These contracts outlined below constitute illegal monopolization and unlawful restraints of trade, and the United States seeks this Court's order declaring Microsoft's anticompetitive contracts illegal and otherwise remedying the unlawful effects of Microsoft's anticompetitive conduct.

Jurisdiction, Venue and Commerce

1. This Court has jurisdiction over this matter pursuant to Section 4 of the Sherman Act, 15 U.S.C. 4, and 28 U.S.C. 1331, 1337.

2. Venue is proper in this district under Section 12 of the Clayton Act, 15 U.S.C. 22, and under 28 U.S.C. 1391 because defendant Microsoft transacts business and is found within this district.

3. Microsoft sells and licenses operating systems for PCs throughout the United States and the world. Microsoft delivers copies of its operating systems to PC manufacturers and retail customers across state lines and international borders. Thus, Microsoft is engaged in, and its activities substantially affect, interstate and foreign commerce. The major developers of other PC operating systems are exclusively U.S. companies.

The Defendant Microsoft and Its Products

4. Microsoft is a corporation organized and existing under the laws of the State of Washington, with its principal place of business located at One Microsoft Way, Redmond, Washington.

5. Microsoft develops, licenses, sells and supports several types of software products for PCs, including "operating systems" and "applications."

6. PC operating systems control the operation of a computer by managing the interaction between the computer's microprocessor, memory and attached devices such as keyboards, display screens, disk drives, and printers. A PC operating system functions as the "central nervous system" of the PC. PC operating system software is designed to work with specific microprocessors, the integrated circuits that function as the "brain" of the computer.

7. Most of the personal computers in the world today use the x86 class of microprocessors, originally designed by Intel Corporation. The x86 class includes Intel 286, 386, 486, and Pentium microprocessors, as well as microprocessors manufactured by other companies that use a substantially similar architecture and instruction set. Unless otherwise specified, the term "PC" refers to personal computers that use the x86 class of microprocessors.

8. In 1980, Microsoft licensed from another company a PC operating system which it modified and introduced in 1981 as the Microsoft Disk Operating System ("MS-DOS"). According to Micro-

soft's 1993 Annual Report, as of June 30, 1993, approximately 120 million PCs in the world utilized MS-DOS.

9. In 1985, Microsoft introduced a more sophisticated PC operating system product it calls "Windows." Windows has a "graphical user interface" which allows users to give instructions by pointing and clicking on their computer screen with a "mouse" or other similar device. Windows also allows users to run more than one application at a time. All versions of Windows released to date require the presence of an underlying operating system, either MS-DOS or a close substitute. Microsoft estimates that over 50 million PCs now use Windows.

10. Applications are software programs that work "on top of" PC operating systems to enable users to perform a broad range of functions. Applications communicate through the PC operating system with the computer's hardware. Commonly used applications include word processors and spreadsheets, such as WordPerfect, Lotus 1-2-3, and Quattro Pro among others. At least 50,000 applications now run on MS-DOS and over 5,000 have been written to run on Windows. Microsoft sells a variety of its own very successful and profitable applications.

11. Microsoft markets its PC operating systems primarily through original equipment manufacturers ("OEMs"), which manufacture PCs. It also markets through independent, non-exclusive distributors. Microsoft has agreements with virtually all of the major microcomputer OEMs.

12. Microsoft generally distributes MS-DOS only to OEMs. To retail customers, Microsoft generally offers only upgrades for

MS-DOS. In the first half of 1994, the share of Windows units sold by Microsoft through the OEM channel was approximately 80%.

The Relevant Market and Microsoft's Monopoly Power

13. The relevant product market is personal computer operating systems for the x86 class of microprocessors (hereinafter the "PC operating system market"). Because operating systems written for other microprocessors will not work on machines with an x86 class microprocessor, OEMs who sell x86 machines and customers who buy such machines cannot use other operating systems.

14. The relevant geographic market is the world.

15. Microsoft has monopoly power in the relevant market and has had monopoly power since at least the mid-1980s. For almost a decade Microsoft has retained an extremely high market share — consistently in excess of 70%.

16. Substantial barriers to entry and expansion exist in the relevant market. One barrier to entry and expansion is the considerable time and expense required to develop, test, and market a new PC operating system. Other interrelated barriers to entry and expansion include:

a. the absence of a variety of high quality applications that run on a new operating system, and the difficulty of convincing independent software vendors ("ISVs") to develop such applications;

b. the lack of a sizable installed base of users; and

c. the difficulty in convincing OEMs to offer and promote a non-Microsoft PC operating system, particularly one with a small installed base and relatively few applications designed to run on it.

17. These barriers magnify and reinforce each other because the value of an operating system to a consumer is directly related to two factors: the availability of a variety of high quality applications that run on that system, and the number of users who use that operating system and thus are able to share information and work with the system without additional training. ISVs, in turn, tend to develop applications for operating systems with a large installed base of users, and consumers gravitate towards operating systems with a large base of applications.

18. Microsoft's anticompetitive contracting practices described below significantly increase the already high barriers to entry and expansion facing competitors in the PC operating system market. These practices reduce the likelihood that OEMs will license and promote non-Microsoft PC operating systems, make it more difficult for Microsoft's competitors to persuade ISVs to develop applications for their operating systems, and impede the ability of a non-Microsoft PC operating system to expand its installed base of users.

Microsoft's Exclusionary and Anticompetitive OEM
Licenses Foreclose Access to the OEM Channel by
Microsoft's PC Operating System Competitors

19. In 1980, IBM agreed to license the original version of MS-DOS from Microsoft for IBM's PC, which experienced consider-

able success. Other OEMs also used MS-DOS in order better to emulate the IBM PC. Microsoft quickly dominated and gained a monopoly in the market for PC operating systems. It then entered into a series of exclusionary and anticompetitive contract terms to maintain its monopoly.

20. Because of Microsoft's monopoly position in the marketplace, OEMs believe that they must offer MS-DOS and Windows to their customers. Profit margins in the computer hardware industry are very thin and OEMs want to obtain MS-DOS and Windows at the lowest possible cost. Microsoft has induced many OEMs to execute anticompetitive "per processor" contracts for MS-DOS and Windows, even though many would prefer to preserve their freedom to offer PCs with non-Microsoft operating systems.

Microsoft's Licenses Impose a Penalty or Tax Paid to Microsoft on OEMs' Use of Non-Microsoft PC Operating Systems

21. Microsoft's licenses impose a penalty or "tax" paid to Microsoft upon OEMs' use of competing PC operating systems. "Per processor" licenses require OEMs to pay a royalty for each computer the OEM sells containing a particular processor (e.g., an Intel 386 microprocessor) whether or not the OEM has included a Microsoft operating system with that computer.

22. Microsoft's per processor contracts penalize OEMs, during the life of the contract, for installing a non-Microsoft operating system. OEMs that have signed per processor contracts

with Microsoft are deterred from using competitive alternatives to Microsoft operating systems.

The Contract Length of Microsoft's Anticompetitive
Per Processor Contracts Magnifies Its Exclusionary Effects

23. Microsoft further impedes PC operating system competitors by executing long-term contracts with major OEMs, and by requiring minimum commitments and crediting unused balances to future contracts, which effectively extends the contract term and makes it economically unattractive for an OEM to install a non-Microsoft operating system.

24. Microsoft's exclusionary licenses are often for a duration of three years or more -- a period of time equal to, or exceeding, the product life cycle of most PC operating system products. Microsoft often extends the term of its OEM licenses through amendment. Thus, Microsoft's anticompetitive per processor contracts can extend to beyond five years.

Microsoft's Exclusionary Contracts Foreclose
Other PC Operating System Vendors From a Substantial
and Critically Important Segment of the Market

25. Access to the OEM channel is critical to the success of a competing operating system. The overwhelming majority of PCs are sold with a pre-installed operating system. Thus, to reach the ultimate consumer of an operating system, it is important

that competitors have access to OEMs. Operating system vendors, as well as OEMs, confirm that successful entry is extremely difficult in the absence of "proper support" in the OEM channel in the form of public commitments to sell a new operating system.

26. Since 1988, Microsoft has induced major OEMs to execute per processor contracts, many of which extend for several years. These OEMs are critical to the success of a new operating system entrant; it would be virtually impossible for a new entrant to achieve commercial success solely through license agreements with small OEMs that are not covered by Microsoft's per processor agreements. According to Microsoft, in fiscal year 1993, per processor agreements accounted for an estimated 60% of Microsoft's MS-DOS sales to OEMs and 43% of Windows sales to OEMs.

27. Competing operating system developers, finding the largest OEMs contractually bound by Microsoft's exclusionary licenses, are disadvantaged in their efforts to bring to the consumer less expensive and/or better quality operating system products.

28. The effect of Microsoft's licensing practices has been to exclude competitors by unreasonable and anticompetitive means and to lessen competition in the relevant market. Microsoft's practices deter OEMs from entering into licensing agreements with competing operating system providers, discourage OEMs who agree to sell non-Microsoft operating systems from promoting those products, and raise the price of computers sold with competing operating systems, thereby depressing the demand and restricting the output of these products. Microsoft's licensing practices

have effectively foreclosed a substantial share of the relevant market; they are exclusionary, anticompetitive, and not justified by legitimate business considerations.

Microsoft's Anticompetitive Non-Disclosure Agreements

29. ISVs develop applications, which motivate consumers to purchase PCs. Microsoft has sought to have several commercially important ISVs and their employees agree to non-disclosure agreements that would restrict their ability to work with competing PC operating systems as well as restrict their ability to develop competitive products.

30. Microsoft moved to impose these restrictions in connection with its "beta tests" of its new operating system, the next version of Windows, code-named Chicago. Microsoft anticipates commercially releasing Chicago in late 1994 or early 1995. Beta tests of new versions of an operating system, which are conducted prior to the commercial release of that new version, help both Microsoft and the ISVs.

31. For the ISVs, the beta tests provide, among other things, critical information about the interfaces in the operating system that connect with applications--information which the ISVs need to write applications that run on the operating system. Early access to the beta tests is especially valuable to the ISVs if they are to be able to release their applications within a short time after the commercial release of a new Microsoft operating system, such as Chicago.

32. For Microsoft, the beta tests enable ISVs, informed experts, and selected members of the media to provide important feedback about the advantages and drawbacks of the operating system. In addition, the demand for Microsoft's operating systems depends to a significant extent on the availability of applications designed to work with it. Accordingly, it is in Microsoft's interest to provide ISVs early access to beta tests.

33. At the same time, because Microsoft necessarily must disclose certain confidential information during the course of the beta tests, it has legitimate interests in maintaining that confidentiality. In the past, Microsoft has protected its interests through non-disclosure agreements that prohibit those participating in the beta tests from disclosing such confidential information.

34. In connection with its beta tests of Chicago, however, Microsoft sought to impose on certain leading software companies far more restrictive non-disclosure agreements than it had previously used. The terms of these non-disclosure agreements would preclude developers at these companies from working with operating system companies, other competitors of Microsoft, and competing technologies for an unreasonably long period of time.

The Anticompetitive Effects of Microsoft's Conduct

35. Microsoft's exclusionary contracting practices have had the effect of excluding competitors on a basis other than competition on the merits and have thereby allowed Microsoft illegally to perpetuate its monopoly in the PC operating system market.

36. Through the unlawful acts and practices described above Microsoft has harmed competition, consumers and innovation:

a. Microsoft has unlawfully maintained a monopoly in the PC operating system market.

b. Microsoft's exclusionary conduct has significantly impeded the ability of rival operating systems to compete in the PC operating system market. Competitors find it more difficult to convince OEMs to offer and/or promote their product and must incur greater marketing expenses to penetrate the market.

Microsoft raised hurdles to fair competition even higher through unreasonably restrictive non-disclosure agreements.

c. Microsoft's exclusionary licenses deprive rival PC operating systems of a significant number of sales that they might otherwise secure. These lost sales impede the ability of PC operating systems to develop an installed base sufficient to convince OEMs to bundle the new system with their hardware, to convince ISVs to write applications that run on the new system, and to convince users that the system is, and will remain, a viable alternative to the existing MS-DOS and Windows standard.

d. Microsoft's conduct also substantially lengthens the period of time required for competitors to recover their development costs and earn a profit, and increases the risk that an entry attempt will fail. In combination, all of these factors deter entry by competitors and thus harm competition.

37. The harm to competition caused by Microsoft's unlawful conduct harms consumers. OEMs that do offer customers a choice of operating systems may charge customers a higher price for PCs

with non-Microsoft operating systems in order to be able to pay the double royalty necessitated by the Microsoft per processor agreements. Thus, users who do not receive a Microsoft operating system are still, indirectly, paying Microsoft.

38. In addition, Microsoft's unlawful conduct has deterred the development of competing operating systems, depriving consumers of a choice of systems with possibly superior features. Similarly, the slower growth of competing operating systems has slowed the development and diffusion of applications designed to work on non-Microsoft operating systems and has limited choices of consumers and users of PCs.

39. Those injured by Microsoft's conduct will continue to suffer such injury unless the relief prayed for herein is granted.

First Claim for Relief -- Sherman Act 2

40. Plaintiff realleges and incorporates herein by reference the allegations set forth in paragraphs 1 through 39 above.

41. By engaging in the acts and practices described above, Microsoft has monopolized the market for PC operating systems in the United States.

42. Such conduct constitutes monopolization in violation of Section 2 of the Sherman Act, 15 U.S.C. 2.

Second Claim for Relief -- Sherman Act 1

43. Plaintiff realleges and incorporates by reference the allegations set forth in paragraphs 1 through 39 above.

44. The licensing agreements and unnecessarily restrictive non-disclosure agreements described above constitute contracts and combinations which unreasonably restrain trade in the market for PC operating systems, which affect interstate trade and commerce, in violation of Section 1 of the Sherman Act, 15 U.S.C. 1.

PRAYER FOR RELIEF

WHEREFORE, PLAINTIFF PRAYS FOR RELIEF AS FOLLOWS:

1. That the Court adjudge and decree that Microsoft has monopolized the interstate trade and commerce in the market for PC operating systems in violation of Section 2 of the Sherman Act.

2. That the Court adjudge and decree that Microsoft has entered into unlawful contracts and combinations which unreasonably restrain the trade in interstate commerce in PC operating systems, in violation of Section 1 of the Sherman Act.

3. That Microsoft and all persons, firms and corporations acting on its behalf and under its direction or control be permanently enjoined from engaging in, carrying out, renewing or attempting to engage, carry out or renew, any contracts, agreements, practices, or understandings in violation of the Sherman Act.

4. That plaintiff have such other relief that the Court may consider necessary or appropriate to restore competitive conditions in the markets affected by Microsoft's unlawful conduct.

5. That the plaintiff recover the costs of this action.

Dated: July 15, 1994

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