

D. Microsoft entered into anticompetitive and exclusionary agreements with OLSs and ISPs

212. As part of its campaign to maintain its operating system monopoly, Microsoft entered into exclusionary agreements with the most important Internet Service Providers (ISPs) and Online Services (OLSs).

212.1. ISPs and OLSs comprise one of the two most important channels for obtaining and retaining browser market share. See infra Part V.D.1.; ¶ 213.

212.2. Microsoft thus determined that gaining preferential treatment for Internet Explorer through ISPs and OLSs, and excluding rivals, was vital to winning the browser war. See infra Part V.D.1.; ¶ 213.3.

212.3. Microsoft entered into exclusionary agreements with the most important ISPs and OLSs. See infra Part V.D.2.; ¶¶ 214-223.

212.3.1. Microsoft believed that, given a free choice, users would choose non-Microsoft browsers. Microsoft's agreements thus not only required preferred distribution and promotion of Internet Explorer, but also prohibited in most circumstances the distribution and promotion of browser rivals.

212.3.2. To induce ISPs and OLSs to agree to the exclusionary terms, Microsoft offered them a large payment; for the most part, that payment took the form of barter, consisting of, among other valuable consideration, access to and distribution through Windows.

212.4. The exclusionary terms in Microsoft's ISP and OLS agreements lack any procompetitive purpose and can be explained only as part of a predatory strategy to maintain

Microsoft's operating system monopoly. See infra Part V.D.4.c.(5); ¶ 256.

1. Microsoft determined that securing distribution for Internet Explorer, and limiting Netscape's distribution, through leading access providers was critical to gaining browser usage share

213. The ISP/OLS channel is one of the two most important (along with the OEM channel) browser distribution channels.

- i. See infra Part VII.A.2.a; ¶¶ 362 - 362.1.
- ii. Cameron Myhrvold, Vice President of Microsoft's Internet Customer Unit and Strategic Relationships, who oversaw Microsoft's relationship with ISPs, testified that "the ISP channel and the OEM channel are the two most important channels for distribution." Myhrvold, 1/19/99pm, at 52:5-7 (quoting Myhrvold's deposition).
- ii. Microsoft's economic expert, Dean Schmalensee, testified that it is consistent with his understanding that ISPs and OEMs are the two most important channels for distributing browsers. Schmalensee, 1/19/99pm, at 52:5-17 (quoting Myhrvold's deposition).

213.1. ISPs and OLSs -- collectively, access providers -- provide access to the Internet and, to facilitate their customers' ability to navigate the Internet, usually distribute a browser to their customers.

- i. To reach the Internet, consumers subscribe, for a fee, to an access provider's Internet service. GX 93. The access provider, in turn, provides a communications link between the consumer's PC and the access provider's server computers. The access provider's servers, in turn, are part of the network of computers that comprises the Internet itself. Myhrvold Dir. ¶¶ 16-17.
- ii. Myhrvold testified that "ISPs typically distributed web browsing software pre-configured for their service to make it easier for the consumer to connect and use the internet." Myhrvold Dir. ¶ 17; see also Colburn Dir. ¶ 7 (AOL distributes a browser to its members as part of its client software).

213.2. Internet users tend to use the browser acquired with their computers or through their Internet access providers.

- i. Brad Chase concluded, in April 1997, that “29% of all Internet users in the US got their browser from their ISP,” and, “we can’t say it enough, ISPs are our most important channel.” GX 510, at MS7 004129 and MS7 004136; Chase, 2/16/99pm, at 23:23 - 24:23 (over 50% of users obtained their browsers from either OEMs or ISPs/OLSs).
- ii. Microsoft’s Bjorn Hovstadius wrote on September 9, 1996, in answer to the question “Why are ISPs important to our Internet mission?” that “[e]very user that wants to get on the Internet needs a connection, and that “[f]or a new user” ISPs are “probably their first exposure to the Internet.” GX 93. Hovstadius provided “data that back[s] this up” showing that more “Internet users got their browser from an ISP or OLS” than through any other channel. GX 93.
- iii. A Microsoft presentation entitled “IE Market Review” written by Kumar Mehta in April 1997 states that more Internet users acquired their browser from an ISP during 1996 and 1997 than from any other source. GX 415, at MSV 10551 - 10552.
- iv. See infra Part VII.A.2.a.; ¶¶ 363 - 363.1 (detailing the reasons that the ISP/OLS and OEM channels are more efficient and effective than alternate browser distribution channels).

213.3. Microsoft thus believed that ISPs and OLSs “drive browser market share” and that gaining preferential distribution and promotion for Internet Explorer through ISPs and OLSs was critical to its objective of winning the browser war.

- i. Microsoft’s December 1996 plan on “Working with ISPs in North America” stated that “**ISPs Drive Browser Market share.** 35% of end-user Internet access customers get their browser from an ISP.” GX 200 (emphasis in original); see also Myhrvold, 2/9/99pm, at 49:12-17, 62:2 -62:21 (testifying that what he meant when he wrote GX 200 was that ISPs were “important for distribution” but later conceding that distribution through ISPs would “result in usage” because “it was a good way to access customers coming on to the Internet.”).

- ii. Myhrvold, in February 1996, told Steve Ballmer, his entire sales force, and others that network operators, including “Internet Access Providers,” are “an important potential asset in the battle for the Internet.” GX 472, at MS6 5003903.
- iii. Brad Chase, Microsoft’s Vice Present for Marketing, Personal and Business System Division, wrote in a confidential April 4, 1996, planning memorandum, entitled “Winning the Internet platform battle,” that licensing Internet Explorer to “all Internet Access Providers” was “the best and fastest way to build share with new users.” GX 39.

213.4. Myhrvold’s effort at trial to recant his earlier testimony (Myhrvold, 2/9/99pm, at 40:3 - 40:8 (asserting that it is “not necessarily true” that ISPs/OLs and OEMs are the two most important distribution channels)) is unpersuasive and incredible:

- i. Myhrvold conceded that, when he testified at his deposition that “the ISP channel and the OEM channel are the two most important channels for distribution,” he was relying on actual studies showing the importance of the ISP/OLS channel. Myhrvold, 2/10/99am, at 33:2-19. As evidenced by what he wrote in his direct testimony, he continues to believe that ISPs are an “important” channel of distribution. Myhrvold Dir. ¶ 20.
- ii. By contrast, Myhrvold’s professed discovery -- while preparing for trial -- that he “was wrong” about the relative importance of the ISP/OLS channel was based on his understanding of Netscape’s marketing announcements about browser downloads, which “fascinated” him. Myhrvold, 2/9/99pm, at 41:2 - 42:19. But Myhrvold neither reviewed Barksdale’s testimony concerning these announcements nor compared his interpretation of these announcements -- that downloading is more important for browser distribution than access providers - - against the very data Microsoft sponsored in this case. Myhrvold, 2/9/99pm, at 43:18 - 44:9.
- iii. Had he done so, Myhrvold would have discovered that Microsoft’s own data showed -- contrary to the thrust of his trial testimony -- that the number of users who said they had acquired Netscape Navigator by downloading did not change between the 1st and 3rd Quarter of 1998. GX 1845 (Chart illustrating that 6.7 million users said they had acquired Netscape Navigator by downloading in both the 1st and 3rd Quarters of 1998); Chase, 2/11/99pm, at 4:12-20. And he would have realized that the 12 million browsers supposedly

downloaded is more than the total number of browsers in use, according to statistics that Microsoft itself sponsored at trial and, therefore, that Netscape's claims about downloading must be incorrect. Myhrvold, 2/9/99pm, at 41:4 - 44:16.

2. In furtherance of its goal of gaining browser usage share, Microsoft entered into exclusionary agreements with the most important ISPs and OLSs

214. Microsoft entered into exclusionary agreements with the major ISPs and OLSs. These agreements, which covered subscribers accounting for more than 95 percent of the top 80 consumer Internet access providers, secured preferential distribution for Internet Explorer and severely restricted the distribution and promotion of non-Microsoft browsers by the most important access providers.

i. Fisher Dir. ¶ 216.

a. Microsoft's exclusionary OLS agreements

215. In exchange for, among other inducements, prominent promotion in a folder located on the Windows desktop (the "Online Services Folder"), AOL, AT&T, CompuServe and Prodigy -- four of the most important Internet access providers -- agreed to a number of restrictions on their ability to promote and distribute non-Microsoft browsers:²

215.1. OLSs are required to distribute and promote Internet Explorer as the exclusive or default browser.

215.2. OLSs are required to restrict severely their promotion of browsers other than Internet Explorer. For instance, OLSs cannot express or imply to a customer that another browser is

² See, e.g., Warren-Boulton Dir. ¶ 103 (outlining typical terms); GX 1213, at MS6 5000388 (sealed) (AT&T Agreement, § 3.3); GX 1148, at MS6 5001000 (sealed) (Prodigy Agreement, §§ 3.3, 3.4); GX 1134, at MS6 5000172 (CompuServe Agreement, § 3.3); GX 804, at AOL 0001738 (AOL Agreement, § 7.2); Myhrvold 2/9/99pm, at 77:14-19 (conceding Microsoft's contracts restricted the distribution of other browsers); Myhrvold 2/10/99am, at 6:14-22 (admitting that his testimony that Microsoft imposed distribution restrictions was "absolutely wrong" was itself wrong); Chase Dir. ¶ 95 ("Although the particulars vary somewhat from OLS to OLS . . . [their agreements] are similar in many ways to Microsoft's agreement with AOL.").

available.

215.3. OLSs cannot provide a non-Microsoft browser to subscribers unless a subscriber specifically asks the OLS to do so.

215.4. In no event -- even in response to specific subscriber requests -- can an OLS ship non-Microsoft browsers that in aggregate amount to more than 15 percent of the total number of browsers shipped by that OLS.

216. America Online's agreement with Microsoft is particularly restrictive:

- i. AOL agreed to "exclusively promote, market and distribute" Internet Explorer. Microsoft and AOL License and Marketing Agreement. GX 804, at AOL 0001738 (§ 7.1).
- ii. Brad Chase, Microsoft's executive in charge of the AOL relationship, wrote that Internet Explorer would be the "standard choice" for all AOL customers; Chase further characterized the exceptions to AOL's use of Internet Explorer as "pretty remote." GX 180.
- iii. David Colburn, Senior Vice President of Business Affairs for AOL, testified that the agreement "provided for virtual exclusivity in favor of Internet Explorer on AOL" and that AOL was "only permitted to ship another browser when required by a third party provider, distributor or corporate account, and only after taking all reasonable efforts to cause the third party to distribute the third party browser on its own; even then, the number of third party browsers that AOL could distribute was limited to less than 15% of AOL's total browser shipments." Colburn Dir. ¶ 29.
- iv. Microsoft's restrictions applied in all channels through which AOL distributed and promoted browsers; they had an effect, therefore, well beyond subscribers who learned about AOL's service through the promotion Microsoft provided AOL through Windows. Colburn Dir. ¶ 28; GX 804, at AOL 0001738 (Microsoft/AOL contract, sections 7.1 and 7.2).
- v. Microsoft's agreement with AOL was so restrictive that, when Netscape agreed to distribute and promote the AOL instant messaging service ("AIM"), AOL was not allowed to promote or distribute Netscape Navigator through AOL's online service in return. Colburn Dir. ¶ 36; see also GX 826 (an internal Microsoft e-mail described

the AIM deal as “nothing major” because, in the words of one Microsoft executive, Internet Explorer was “still their default client, new users still get IE, old users still get upgraded to IE.”); GX 831.

216A. Microsoft’s suggestion that the AOL agreement did not provide for “virtual exclusivity” for Internet Explorer (MPF ¶¶ 756-57, 797), and its assertions that “AOL has always been free to provide non-Microsoft Web browsing software to any subscriber who requests it” and that there are a “series of broad exceptions” to the AOL agreement that permits AOL to promote and distribute non-Microsoft browsers (MPF ¶¶ 797; 823), are highly disingenuous and contrary to the facts.

- i. Microsoft’s contract with AOL expressly states that AOL cannot provide non-Microsoft browsers to subscribers (even if specifically requested) if doing so would cause AOL to exceed the shipment restrictions. See supra Part V.D.2.a; ¶ 215.4. Furthermore, for third-party providers, distributors, or corporate accounts that might request a non-Microsoft browser, the contract requires AOL to cause that third party to acquire or ship the non-Microsoft browser and to minimize its brand name association with it. See supra Part V.D.2.a; ¶ 216; GX 804, at 16.**
- ii. Microsoft admits that the OLS agreements “limit the OLSs’ ability to promote and distribute non-Microsoft Web Browsing Software.” MPF ¶ 823.**
- iii. Brad Chase recognized when the AOL agreement was entered into that the likelihood of an AOL subscriber using another browser was “pretty remote.” GX 180. See also Chase, 2/11/99pm, at 68:4 - 69:6.**
- iv. Microsoft attempts to support its contention that there are a “series of broad exceptions” to the restrictions on AOL by pointing out that AOL may distribute non-Microsoft browsers to users “for platforms other than Windows 9x, Windows NT, Apple Macintosh, and Windows 3.x.” MPF ¶ 798 (emphasis added). Such platforms (e.g., OS/2) account for a very small share of users, and AOL does not even have access software for some of them (e.g., Unix).**
- v. While Microsoft notes that AOL is permitted to provide links in “a limited number of locations” to Web sites from which non-Microsoft browsers may be**

downloaded (MPF ¶ 799), it neglects to add that AOL's contract with Microsoft prohibits AOL from placing a message on the screen advising users that they may download Navigator, or telling them where to go to do so. See *infra* Part V.D.4.c.; ¶ 250.2.1.3.

b. Microsoft's exclusionary ISP agreements

217. Microsoft entered into similar restrictive agreements with ISPs. As with its OLS agreements, Microsoft exchanged valuable consideration, including promotion for ISPs through another folder on the Windows desktop (the Internet Connection Wizard, or "ICW," which connected to Microsoft's Internet Referral Server). In exchange, the ISPs typically agreed, in so-called Internet Referral Server ("IRS") agreements, to the following restrictions on their ability to promote and distribute non-Microsoft browsers:³

217.1. ISPs must offer Internet Explorer as the standard or default Web browser.

217.2. ISPs must restrict severely their ability to promote browsers other than Internet Explorer, including agreeing not to express or imply that other browsers are available.

217.3. ISPs may not provide another browser to a subscriber unless specifically requested to do so by the subscriber.

217.4. Even when a customer specifically requests another browser, the ISP cannot provide another browser if doing so would cause the total shipments of its non-Microsoft browsers to

³ See, e.g., Fisher Dir. ¶¶ 184-185 (detailing typical terms of ISP agreements); GX 1141, at MS6 5000007 (sealed) (Earthlink agreement, § 3.1); GX 1140 (summary of the Brigadoon agreement); GX 1147 (summary of the IDT Corp. agreement); GX 1144, at MS6 5001130 (sealed) (SpryNet agreement, § 3.1); GX 1146, at MS6 5000924 (sealed) (Mindspring agreement, § 3.1); GX 1213, at MS6 5000388 (sealed) (AT&T agreement, § 3.3); GX 1214, at MS6 5000953 (sealed) (Netcom Agreement, § 3.1).

exceed a specified percentage, typically 25%, of all browsers shipped by that ISP.

217.5. Some ISPs entered into agreements with Microsoft that included even more stringent distribution restrictions.

- i. Microsoft prevented Brigadoon from shipping other browsers with more than 10% of total browser shipments. GX 1140.
- ii. Microsoft prevented IDT from shipping other browsers with more than 15% of total browser shipments. GX 1147.

218. The testimony of MCI's Stephen Von Rump illustrates how Microsoft's ISP agreements disadvantaged non-Microsoft browsers.

- i. MCI could not tell its customers that other browsers, such as Netscape, were available or provide Netscape to customers unless specifically requested. Von Rump Dep., 1/13/99, at 323:25 - 324:21. By contrast, MCI was required to promote Internet Explorer as the "browser recommended for use" with its ISP service. Von Rump Dep., 1/13/99, at 326:13-18.
- ii. Microsoft required MCI to place an Internet Explorer logo on its Internet service's home page, along with a link to an Internet Explorer download site, but prohibited MCI from including similar links or promotion for Netscape or taking paid advertising to promote Netscape Navigator. Von Rump Dep., 1/13/99, at 324:23 - 327:4.
- iii. As with its agreements with OLSs, Microsoft's restrictions applied to MCI subscribers who became subscribers through means other than through the ICW. GX 1132, at MS6 60008292 (Addendum A to the Microsoft/MCI agreement, § 2.1) (sealed).

c. Microsoft's Exclusionary "Internet Explorer preferred" agreements

219. Microsoft also entered into several hundred "IE preferred" agreements with smaller ISPs.

- i. A Microsoft study indicated that ISPs representing 95% of Internet access users had signed "IE Preferred" Agreements. GX 350.
- ii. Fisher testified that "more than 95 percent of subscribers to ISPs in the 'Top 80' subscribe to ISPs that were contractually required to distribute IE preferentially".

Fisher Dir. ¶ 216 (referring to GX 12).

220. Microsoft granted these ISPs royalty-free rights to customize and distribute Internet Explorer in return for their agreeing to make Internet Explorer the ISP's "preferred" browser.

- i. In his direct, Cameron Myhrvold describes an ISP's ability to customize Internet Explorer with the IEAK, which was free to ISPs. The IEAK allows ISPs, when customizing Internet Explorer, to change the default home page to point to the ISPs' service. Myhrvold Dir. ¶¶ 33, 34.
- ii. In answer to the question "What are we offering ISPs?", Microsoft's Bjorn Hovstadius wrote on September 9, 1996, "The basics - A license to distribute IE for free. If an ISP is willing to make IE the preferred browser and agree to a few other requirements in our license agreement we offer to license IE and its add-on components for free. We allow them to distribute another browser if they wish but it is very important that IE is the preferred browser. We will not sign deals were that not the case." GX 93
- iii. As Myhrvold conceded, Microsoft considered ISPs to be in breach of these agreements if they did not make Internet Explorer the "default" or "preferred" browser. Myhrvold, 2/10/99pm, at 42:3 - 43:7.

d. Microsoft anticipated that its exclusionary agreements would wrest significant browser share from Netscape

221. Without restrictions on the distribution of rival browsers, Microsoft believed that ISPs would give users a "side-by-side" choice of browsers and that users would chose Netscape Navigator over Internet Explorer. Microsoft's restrictions were specifically designed to wrest potential users away from Netscape.

- i. Cameron Myhrvold admitted that Microsoft believed the restrictions were necessary precisely because of consumer demand. Microsoft feared that offering users a "side by side" choice of browsers would result in users choosing Netscape Navigator over Internet Explorer. Myhrvold, 2/10/99am, at 62:7-20.
- ii. ISPs/OLSs favor giving users a choice of browsers. Myhrvold, 2/9/99pm, at 72:12-14. See infra Part V.D.4.c.(2); ¶ 251.

- iii. ISPs/OLSs initially resisted Microsoft's browser distribution restrictions because they wanted more flexibility to meet consumer demand. See, e.g., GX 198 (Prodigy believed that its Microsoft agreement contained "a number of extremely objectionable provisions"); GX 228, at MS98 0113059 (Netcom resisted signing restrictive Internet Explorer 4 referral server agreement that would impede its ability to satisfy its customers.)

222. Microsoft's exclusionary agreements with ISPs/OLSs covered the most important access providers.

222.1. The ISPs and OLSs that agreed to Microsoft's OLS and IRS agreements accounted for a large percentage of Internet access in the United States.

- i. By June 1997, 14 of the top 15 access providers in North America were included in the OLS Folder or ICW and shipped Internet Explorer as their preferred browser. GX 211.
- ii. James Barksdale testified that, although there are thousands of ISPs, over 75% of the world's Internet users access it from the 8 to 10 largest providers. Barksdale Dir. ¶ 129. Barksdale also referred to a report on "Consumer Choice in Web Browsers" based on a June 1998 survey of top ISPs which concluded: "The disturbing reality is that the four largest retail Internet Service Providers, with a combined subscriber base of over 20 million customers, distribute only Internet Explorer to their customers." Barksdale Dir. ¶ 158.
- iii. Colburn testified that AOL believed that with an AT&T deal, Microsoft would own most of the consumer audience for browsers. Colburn, 10/29/98pm, at 61:16 - 62:7; see also DX 502 (AOL believed that, with a CompuServe deal, Microsoft would "own the consumer franchise for browsers.").

222.2. The AOL deal was particularly significant to Microsoft's effort to gain browser share because AOL was and remains the largest access provider.

- i. At the time it signed its agreement with Microsoft, AOL was (and remains) the largest single access provider. Silverberg, 1/13/99, at 684:4 -685:10; Fisher Dir. ¶ 178. In 1998, AOL had in excess of 13 million subscribers, with its members generating over 1 billion Web hits daily. Colburn Dir. ¶ 6.

- ii. In an e-mail written to the executive staff in March 1996, Brad Chase wrote, “This partnership significantly expands the IE customer base for third party developers and shows how serious we are about getting browser share.” He states that U.S. market share data indicates that, “Having AOL users in our camp gives our Internet technologies and platform a powerful market presence.” GX 180.
- iii. In January 1996, Bill Gates wrote that, “What we want from AOL is that for a period of time - say 2 years - the browser that they give out to their customers and the one they mention and put on their pages and the one they exploit is ours and not Netscapes. We want all the hits that come off of AOL to register on servers as our browser so people can start seeing us as having measurable browser share.” DX 1545.
- iv. Indeed, Microsoft’s Ben Slivka reported to Paul Maritz and others that having AOL, CompuServe, and MSN offering Microsoft technology was akin to having “Compaq and IBM in the early MS-DOS days.” GX 811.

222.3. The coverage of Microsoft’s exclusionary agreements is even broader when its

“IE preferred” agreements are included:

- i. A Microsoft study entitled, “Netscape Competitive Analysis: ISP/OLS Channel Revenue Segment” describes ISPs and OLSs by their contractual relationship with Microsoft and Netscape. These relationships are broken up into three categories: Internet Explorer Preferred, Netscape Preferred, and Internet Explorer Parity. Eighty-two percent of the ISPs surveyed which reported shipping browsers were categorized by Microsoft as Internet Explorer Preferred. GX 835, at MS98 0112828; see also GX 1092, at MS98 0112836 (same).
- ii. ISPs that were required to make Internet Explorer their preferred browser accounted for more than 96% of Internet access subscribers. GX 835, at MS98 0112826-7.
- iii. According to Microsoft’s tracking documents, the vast majority of the large ISPs in North America, and the four major North American online services, have all entered into agreements with Microsoft that require Internet Explorer to be the preferred or virtually exclusive browser. GX 1833.
- iv. Microsoft estimated that, by September 1996, more than 2,000 ISPs had

signed preferential distribution agreements with Microsoft. GX 93.

- v. A FY98 Mid-Year Review of the Internet Customer Unit reported that 45 of the top 50 ISPs are “IE Preferred” and “82% of Breadth ISPs ship IE as the primary browser.” GX 424, at MS7 000588 (sealed).

223. The exclusionary provisions in Microsoft’s contracts apply to all browser distribution and promotion by the covered access providers, not just to distribution and promotion of browsers to those subscribers acquired through the OLS Folder or ICW.

- i. Myhrvold wrote on April 3, 1997: “Remember that ISPs have to swear allegiance to IE for typically 75% of all the browsers they distribute in order to get into the referral server.” GX 440 (emphasis added).
- ii. The shipment restrictions in Microsoft’s contracts with ISPs also specifically state that the restrictions cover “total shipments of all web browsers through or by the ISP service”. E.g., GX 1141, at MS6 500007 (Earthlink agreement, § 3.1) (sealed); GX 1140 (summary of the Brigadoon agreement); GX 1147 (summary of the IDT Agreement); GX 1144, at MS6 5001130 (sealed) (SpryNet agreement, § 3.1); GX 1146, at MS6 5000924 (Mindspring agreement, § 3.1) (sealed); GX 1213, at MS6 5000386 (AT&T agreement, § 3.3) (sealed); GX 1214, at MS6 5000953 (Netcom Agreement, § 3.1) (sealed).

3. The importance of the exclusionary terms is evidenced by how much Microsoft paid ISPs and OLSs to enter into the agreements

224. Microsoft secured its exclusionary agreements by offering ISPs and OLSs what amounted to a very large bribe. That bribe included both valuable technology and technical assistance and Microsoft’s provision of valuable promotion through Windows.

- i. Professor Fisher testified that “Microsoft also made valuable concessions, directly and indirectly, to the ISPs. These varied across ISPs but included joint marketing programs, pricing deals, and discounts from referral fees for users switched from competitive browsers.” Fisher Dir. ¶ 182.
- ii. Dr. Warren-Boulton testified that Microsoft made ISPs “an offer they couldn’t refuse”

to distribute Internet Explorer to at least 75% of their subscribers. Warren Boulton 11/30/98pm, at 24:16 - 26:22.

a. Microsoft paid significant value other than promotion through Windows to induce ISPs and OLSs to agree to its exclusionary terms

225. Microsoft provided OLSs and ISPs with valuable technology, technical assistance, and other consideration for free, expecting both distribution for Internet Explorer and the exclusion of browser rivals in return. This valuable consideration included, among other things, the following:

225.1. Internet Explorer. Microsoft did not charge OLSs or ISPs for Internet Explorer, even though Microsoft spent millions developing and improving Internet Explorer, including a “componentized” version that ISPs and OLSs could use to promote their own products and services.

- i. See infra Part V.G.
- ii. Brad Chase described how Microsoft embarked upon a costly effort to componentize Internet Explorer. Chase Dir. ¶¶ 19-21.
- iii. Microsoft believed that giving away its technology would facilitate its objective of persuading ISPs to agree to restrict their distribution of rival browsers. See, e.g., GX 39, at MS6 5005720 (“You should be able to break most of the Netscape licensing deals and return them to our advantage because our browsers are free”); GX 472, at MS6 5003904 (because it is “essential” to increase browser share, Microsoft will “license at no cost the Internet Explorer for distribution”).

225.2. Technical assistance. Microsoft provided OLSs and ISPs with valuable technical assistance for which Microsoft did not charge.

- i. Chase testified about the extensive technical aid Microsoft provided to AOL, including hiring developers to work exclusively with AOL and making “significant changes to Internet Explorer to meet some of AOL’s requests” Chase Dir. ¶¶ 51-52.

225.3. Source code. Microsoft gave AOL a free source code license to Internet

Explorer.

- i. Chase testified: “The willingness to divulge source code to AOL demonstrated how far Microsoft was willing to go to win AOL’s business” Chase Dir. ¶ 42; see also Chase Dir. ¶ 69 (detailing Microsoft’s grant of source code rights for various versions of Internet Explorer to AOL); GX 804, at AOL 0001724, - 1759 (§ 1.1 and attachment 1) (granting source code license).

225.4. Customization of start page. Microsoft provided free browser customization software, known as the Internet Explorer Administration Kit (“IEAK”), to OLSs and ISPs. This software, among other things, allows OLSs and ISPs to change the default home page on the browser to point to the OLSs’ or ISPs’ Web sites, rather than to Microsoft’s. In effect, Microsoft thus transferred to ISPs and OLSs revenues it could have obtained from its home page.

- i. Cameron Myhrvold testified that Microsoft promoted ISPs’ services by, among other things, “granting each ISP the right to customize Internet Explorer for its service.” Further, he explained that Microsoft licensed the IEAK at “no charge,” allowing “each ISP to preset the default home page so that customers would be taken to the ISPs’ Web site whenever they logged onto the Internet.” Myhrvold Dir. ¶¶ 10, 32-33. See also GX 39, at MS6 5005720 (describing a free customization kit available with Internet Explorer 3.0 which enabled ISPs to use their own brand and logo).
- ii. Intuit’s William Harris testified, based on a representation from William Poole of Microsoft during the break of his cross examination, that Microsoft will continue to allow ISPs to change the default home page in Internet Explorer 5. Harris, 1/5/99am, at 42:16 - 43:3.

226. Microsoft in some cases paid cash (or its equivalent) to ISPs and OLSs to facilitate their acceptance of restrictive terms.

- i. Microsoft paid off minimum commitments owed by the OLSs’ and ISPs’ to Netscape, in order to induce a switch to Internet Explorer. Myhrvold Dir. ¶ 29. For example, Brad Silverberg told AT&T that Microsoft would allow AT&T to use revenue from

ICW bounties to pay down the Netscape minimum commitments if AT&T agreed to ship Internet Explorer on a preferred basis. GX 179.

- ii. Microsoft created co-marketing funds for ISPs that would offer Internet Explorer on a standard or default basis. Myhrvold described a co-marketing fund of up to five million dollars which Microsoft created to enable MCI to switch Web browsing software. Myhrvold Dir. ¶ 29.
- iii. Microsoft offered to pay down AT&T's \$17 million minimum commitment to Netscape in return for AT&T's commitment to abandon Netscape Navigator and sign a restrictive deal with Microsoft. GX 179.
- iv. Microsoft offered discounts on the referral server bounties owed to it by ISPs for every Netscape Navigator user (or user of other browser) converted to Internet Explorer. Myhrvold Dir. ¶ 62; Myhrvold, 2/10/99pm, at 11:18 - 13:2; see also GX 81 ("Here is what we have proposed for upgrading Netcom's existing customers to IE. It is essentially a 'reverse bounty' of \$9."); GX 86 (discussing Microsoft's to "offer a [sic] exclusive discount for all of their Netscape customers who move to IE (and not other browser's users) in exchange for waiving the fee to get on the referral server.").
- v. Microsoft paid UUNet \$500,000 for UUNet's abandonment of Netscape Navigator. DX 2260, at 6(§ 5.1) (UUNet Internet Referral Server Agreement). Myhrvold's admission that the payment occurred (Myhrvold Dir. ¶ 117) combined with the contemporaneous documents asking how much it would take to "get Pipex [UUNet] off of Netscape" (GX 1812), make Myhrvold's current denial that the payment had anything to do with browsers dubious at best. Myhrvold, 2/10/99am, at 21:18 - 26:14. Indeed, Myhrvold e-mailed a Microsoft employee working on the UUNet account that "I actually think tying the payment to their shipping IE is a great idea, though I would not do this formally." GX 102. His explanation of this e-mail at trial -- that he was merely attempting to provide encouragement to a remote employee via e-mail but immediately called him to tell him it would not be "appropriate" is incredible. Myhrvold, 2/10/99pm, at 44:22 - 45:20 (attempting to explain away the plain language of GX 102).

b. Microsoft also bribed ISPs and OLSs by offering what both access providers and Microsoft viewed as valuable promotion through Windows

227. One of the most valuable assets that Microsoft used to induce OLSs and ISPs to enter into restrictive agreements was promotion of their services through Windows.

- i. Dr. Warren-Boulton testified that Microsoft used promotion through Windows to “induce OLSs to enter into agreements that restricted the distribution and promotion of competing browsers.” Warren-Boulton Dir. ¶ 102.
- ii. Professor Fisher testified: “Microsoft had power over what is referred to here as real estate, positions on the desktop and in the system. One of the things Microsoft could perfectly well have done would be to charge a high price for that.” Fisher, 1/12/99am, at 27:8-12.

(1) Promotion in Windows is valuable to ISPs and OLSs because Windows is ubiquitous and users tend to select Internet access providers promoted through Windows

228. Promotion through Windows, whether in the start-up sequence, on the Windows desktop, or in a prominent folder on the desktop, is extremely valuable to ISPs and OLSs.

228.1. Because Windows is shipped on more than 90% of personal computers, it provides the equivalent of a ubiquitous billboard, one that will be viewed by millions of computer users. The impact is especially important for Internet-related services; users, particularly novices, tend to select Internet-related services that are prominently advertised in the start-up sequence or desktop.

- i. David Colburn testified that placement in the Windows box was especially valuable in reaching novice users without an Internet connection, a set of users Colburn described as “AOL’s niche.” Therefore this distribution channel was “infinitely more fertile for subscriber acquisition” than other distribution methods. Colburn, 10/29/98pm, at 45:5 - 46:2 In general, software already loaded on a computer is a “uniquely effective method of distribution and promotion,” and placement of an icon “on the desktop would be a uniquely effective method of promotion and installation.” Colburn Dir. ¶ 18
- ii. MCI believed that the company’s inclusion in the Internet Connection Wizard which appeared in the course of using and installing Windows was valuable because it would give the ISP access to a large number of potential users. Von Rump Dep., 1/13/99, at 322:2 - 323:15.
- iii. Dr. Warren-Boulton testified that “the Windows 95/98 desktop and boot-up sequence provide an attractive advertising vehicle for OLSs. Placement on

Windows screens is valuable to OLSs because, among other reasons, it ensures that the OLS reaches many potential new subscribers at the precise time when those new subscribers must open an account to secure access to the Internet. Warren-Boulton Dir. ¶ 101; see also supra Part V.C.1.a; ¶ 176.1.

228.2. Promotion through Windows is also valuable because, in contrast to other means of promoting Internet access services, such as mass mailing, it involves virtually no costs except purchasing the placement itself from either Microsoft or OEMs. It is a more cost-effective means of reaching potential subscribers than other methods, such as mass advertising and mailing.

- i. Steve Case told James Barksdale that placement on the Windows desktop was "extremely valuable" to ISPs because it meant "immediate access to Windows users -- who constitute over 90% of personal computer users -- without incurring the substantial hard-dollar costs associated with other distribution methods." Barksdale Dir. ¶ 31.
- ii. Cameron Myhrvold testified that inclusion in the Windows Referral Server is an "economic channel" for ISPs because "ISPs can acquire a customer via the Windows Referral Server at a lower cost than they acquire a customer from their own sales and marketing channels. Myhrvold Dir. ¶ 86 (explaining that the average cost paid by ISPs through other channels is approximately \$42.50 which is higher than the referral fees that ISPs pay to Microsoft). Myhrvold also admitted that the Internet Connection Wizard "represents a good value to ISPs since it is a cheaper way of acquiring customers than the industry average of acquiring customers. So I would say for most ISPs it is a good value, yes." Myhrvold, 2/10/99am, at 31:5-9.
- iii. Dean Schmalensee conceded that control over Windows gives Microsoft the ability to obtain wide promotion and distribution of products at minimal expense. Schmalensee, 1/19/99pm, at 41:13 - 42:11 (Microsoft considered placement on the Windows desktop an important distribution channel for Internet Explorer).
- iv. Microsoft also believed that its ability to promote and distribute MSN through the Windows desktop gave MSN service a "huge advantage over the competition.... AOL and CompuServe had to spend \$40 to \$80 to acquire each new customer. It was very expensive to offer bounties and ship free disks around the world. In the meantime, MSN could acquire new customers

virtually for free.” GX 1372, at 4-5.

(2) Microsoft created, and gave away, prominent desktop placement for ISPs and OLSs that agreed to its exclusionary terms

229. Microsoft created folders on the Windows desktop designed to promote ISPs and OLSs that agreed to its exclusionary restrictions and used its power over OEMs to prevent them from removing those folders.

- i. Microsoft created the Online Services Folder for the Windows 95 and 98 desktop which contained icons representing participating OLSs. A user clicking on an OLS’s icon is invited to register for the particular OLS’s Internet service. Warren-Boulton Dir. ¶ 102; Fisher ¶¶ 174-175.
- ii. Microsoft also included with Windows, beginning with OSR 2.0, the Internet Connection Wizard. Myhrvold Dir. ¶ 43. In Windows 95, the ICW consisted of a icon prominently placed on the Windows desktop that, when a user invokes it, takes the user to Microsoft’s Referral Server, which in turn lists several ISPs. As with the OLS folder, a user that selects a particular ISP is invited to register for that ISP’s service. Myhrvold Dir. ¶ 44; GX 93 (explaining that the ICW allows users to choose an ISP and complete the sign-up for an Internet account).
- iii. In Windows 98, Microsoft moved the ICW up to the Windows boot up sequence and thus made it even more prominent. GX 176A, at MSV 0009137A.

230. Despite its current assertion that the OLS Folder and ICW were designed merely to make it easier to connect to the Internet (Myhrvold Dir. ¶ 45), Microsoft believed at the time it developed those folders that access providers would find them extremely valuable and that the prospect of obtaining promotion through them would induce access providers to agree to Microsoft’s exclusionary restrictions. Microsoft created the OLS folder and the ICW with the purpose of trading their value for exclusion of rival browsers.

- i. Cameron Myhrvold admitted that “the referral server was partly created in order to

induce ISPs to commit to IE on a preferred basis.” Myhrvold, 2/10/99am, at 29:12 - 31:25.

- ii. Myhrvold described the requirements for being in the Online Services Folder as “high” and explained that ISPs would have to agree to ship Internet Explorer to at least 85% of their customers. He wrote that the “Internet/ISP folder... will be the folder used to promote Internet access along the lines we have discussed (commit to IE on exclusive/preferred basis, co-branded startpage, bounty, etc.)” GX 185.
- iii. In a 1996 market plan entitled “How to Get to 30% Share in Three Months”, Brad Chase wrote that Microsoft needed to “open up the Windows box” in order to “remove barriers to browser adoption by Online Services and Internet Access Providers.” GX 334, at MS98 0104682.

231. Microsoft made clear during its negotiations with ISPs and OLSs, and in the agreements it extracted, that access to the OLS Folder and Internet Referral Server were linked to access providers’ agreement to exclusionary restrictions.

- i. Microsoft executive Brad Silverberg testified that inclusion in the “Windows box” provided “potentially great value” to access providers. Silverberg Dep., 1/13/99, at 689:16-25. In exchange for giving access providers this value, Silverberg explained, Microsoft would require “exclusive or very very preferential treatment” for Internet Explorer. GX 183.
- ii. As Silverberg told AT&T during negotiations: “You want to be part of the Windows box, you’re going to have to do something very special for us. There are very, very few people we allow to be in the Windows box. If you want that preferential treatment from us, which is extraordinary treatment, we’re going to want something very extraordinary from you.” Silverberg Dep., 1/13/99, at 692:12 - 693:25; see also GX 183.

232. Microsoft’s Chairman Bill Gates’ decision to use Windows placement to extract exclusionary terms -- rather than to charge for such placement or use that placement to advantage Microsoft’s Internet access service, MSN -- illustrates the importance to Microsoft of thwarting the threat that non-Microsoft browsers posed to its operating system monopoly.

232.1. Mr. Gates initially took the position, in negotiating with AOL, that distribution with Windows was “sacrosanct” and could not be part of any deal relating to AOL’s distribution of Internet Explorer.

- i. According to an internal AOL e-mail reporting on a January 18, 1996 meeting between AOL and Microsoft, Gates made it clear that “the Windows Box itself is ‘sacrosanct.’ No way AOL could drop the entire client into Windows for distribution.” GX 38.
- ii. Chase testified that “Mr. Gates expressed frustration at Mr. Case’s focus on getting an AOL icon on the Windows desktop. Mr. Gates said he would not agree to that demand.” Chase Dir. ¶ 43. Chase further explained, in reference to a January 26, 1996 meeting, that “Mr. Gates strongly resisted the idea of promoting AOL’s service (which competed with MSN) by placing an AOL icon on the Windows desktop.” Chase Dir. ¶ 45.
- iii. As Brad Silverberg testified, Gates was “very, very uncomfortable” about giving AOL placement on the desktop because Gates “felt it was putting a bullet through MSN’s head.” Silverberg Dep., 1/13/99, at 703:13 - 705:11.
- iv. Gates agreed with the Microsoft executive who ultimately became responsible for MSN that including AOL on the desktop “gives away our one unique and valuable asset -- Windows distribution -- at way too low a price. . . . The only real advantage [MSN] has in this game is Windows distribution.” GX 130.

232.2. Mr. Gates ultimately decided, however, that promoting Internet Explorer was more important than protecting MSN’s biggest competitive advantage of being the only access provider with distribution through Windows.

- i. As Cusumano and Yoffie report, Gates concluded that bartering promotion through Windows for exclusionary terms, thereby helping to protect Microsoft’s dominant position in operating systems, was more valuable than protecting MSN. Gates said: “We have had three options for how to use the ‘Windows box:’ First, we can use it for the browser battle, recognizing that our core assets are at risk. Second, we could monetize the box, and sell the real estate to the highest bidder. Or third, we could use the box to sell and promote internally content assets. I recognize that, by choosing to do the first, we have

leveled the playing field and reduced our opportunities for competitive advantage with MSN.” GX 1372, at page 5.

232.3. In other words, Mr. Gates realized that securing preferential distribution for Internet Explorer through AOL, and thus blunting the platform threat Netscape posed, was worth a very substantial payment.

- i. David Colburn of AOL was told that Microsoft had “no limitations on what it would spend to gain market share for Internet Explorer.” Colburn Dir. ¶ 38.
- ii. AOL executives reported, in a write up detailing the meeting, that Mr. Gates used “characteristically blunt” words during a meeting to express this sentiment when he asked AOL “how much do we need to pay you to screw NS?” GX 38.
- iii. Professor Fisher testified that Microsoft has an incentive to pay AOL a significant bribe to continue to favor Internet Explorer as an insurance policy against a paradigm shift. Fisher, 6/1/99pm, at 66:25 - 67:12.

(3) As Microsoft predicted, OLSs and ISPs agreed to its exclusionary restrictions to obtain valuable desktop placement

233. As Microsoft anticipated, ISPs and OLSs saw the opportunity to be included with Windows as very valuable and agreed to Microsoft’s exclusionary restrictions in order to obtain that desktop promotion.

- i. Prodigy concluded that placement in the Online Services Folder was “absolutely critical to Prodigy’s business” and “essential in order to remain competitive.” Thus, Prodigy “had no choice but to accept an agreement” with Microsoft which contained “a number of extremely objectionable provisions.” Although Prodigy requested that a section of the agreement limiting the number of competing browsers Prodigy could ship be deleted, Microsoft refused. Microsoft was also unwilling to negotiate other terms, such as the prohibition on including any links on the Prodigy Internet service to browsers other than Internet Explorer. GX 198.
- ii. Brad Chase understood that AT&T “really, really want[ed] to be in the Windows box.”

Chase, 2/16/99am, at 67-68 (quoting GX 179). And Microsoft executives reported after a meeting with AT&T that they were still in “good shape on the browser as long as we hold strong on the preferred status for getting ‘in the box.’” GX 183.

- iii. Cameron Myhrvold testified in his deposition that he had no doubt that AT&T “very badly” wanted placement in the Windows box and that Microsoft told them that they could not have this placement if AT&T “gave equal placement to Netscape’s Navigator.” Myhrvold, 2/10/99am, at 18:12 - 21:3.
- iv. Brad Silverberg was clear in his deposition testimony that distribution through Windows was of “tremendous value” as a “customer acquisition facility,” especially since OLSs such as AT&T would be shipped with “every copy of Windows.” Silverberg, 1/13/99, at 689:16 - 691:9.
- v. CompuServe believed that inclusion in the Online Services Folder represented a very large distribution opportunity — one which no other single hardware or software company could match without greater expense. Warren-Boulton Dir. ¶ 101 (quoting Knott Dep., 2/20/98, at 21-23). In turn, according to Dr. Warren-Boulton, “Microsoft used this asset to induce OLSs to enter into agreements that restricted the distribution and promotion of competing browsers.” Warren-Boulton Dir. ¶ 102.
- vi. MCI was very interested in being included in the Microsoft Internet referral server because it represented access to a large market of potential MCI Internet subscribers. Microsoft stressed to MCI the value of inclusion, on the reasoning that the referral server would ship with every copy of Windows. Von Rump Dep. 1/13/99, at 322:2 - 323:15.

(4) AOL viewed promotion through Windows as particularly valuable and would not have agreed to Microsoft’s exclusionary restrictions absent placement in the Windows OLS Folder

234. AOL viewed obtaining promotion through Windows as particularly important because of Microsoft’s promotion on the Windows desktop of AOL’s principal rival, MSN, and the relatively low cost of acquiring potential subscribers through distribution with Windows.

- i. Brad Chase testified that AOL’s Steve Case “was very passionate about the whole issue of MSN and AOL, and we believed he would be passionate about trying to get into the Windows box as well.” Chase, 2/11/99pm, at 74:24 - 75:23.

- ii. David Colburn testified that, by bundling MSN with Windows, “Microsoft was able to ensure that every consumer who purchased either a new computer or a Windows 95 product at retail had MSN easily available.” Colburn argued that this placement gave Microsoft a “potentially decisive strategic advantage”. Colburn Dir. ¶ 15; Colburn, 10/28/98pm, at 52:3-8 (MSN’s distribution opportunities on the Windows desktop were a “major concern” for AOL).
- iii. By contrast, other distribution channels used by AOL -- such as mailing software directly to individual potential subscribers -- were more costly and required “more effort by the consumer to access AOL” than was required for consumers to access MSN, which was included with Windows. Colburn Dir. ¶ 17. Distribution through Windows, in short, was “uniquely effective.” Colburn Dir. ¶ 18.

235. **Despite Microsoft’s claim to the contrary (MPF ¶ 790), AOL thus believed that obtaining promotion through Windows would be extremely valuable, a judgment in which Microsoft shared.**

- i. AOL executive Miles Gilburne told James Barksdale, at the time AOL struck its deal with Microsoft, that the Microsoft deal was worth an extra 750,000 to a million subscribers per year and therefore the deal provided a “very powerful marketing opportunity” for AOL. Barksdale, 10/21/98am, at 65:5-18.
- ii. After the deal, Steve Case continued to believe that access to Windows was valuable. He wrote that AOL should “move heaven and earth” to get the best version of AOL integrated into Memphis (Windows 98), which was a “huge” deal. Case directed AOL executives to approach this project with a “jihad like focus.” GX 441.
- iii. During his cross examination, David Colburn calculated that the value of AOL’s placement in the Online Services Folder was, for the 1997-1998 time period alone, “far, far in addition” Colburn, 10/29/98am, at 12:1 - 13:21 (sealed session). **This calculation far exceeds Dean Schmalensee’s flawed calculation cited by Microsoft (MPF ¶ 790); see infra Part V.D.3.c.; ¶ 237.2.2 (discussing the flaws in Dean Schmalensee’s calculation).**
- iv. A Microsoft summary of the operative terms of the AOL/Microsoft contract notes that Windows distribution “has had a substantial benefit to AOL as a large % of its subscriber growth has come from this source.” GX 1127.

236. AOL would not have made Internet Explorer its standard browser, or accepted

Microsoft's other exclusionary terms, absent placement in the Online Services Folder.

- i. Colburn testified that "AOL would not have been willing to negotiate a browser license with Microsoft had Microsoft not indicated a willingness to bundle and promote the AOL client software in some form with Windows. Distribution and promotion on the Windows desktop was one of AOL's goals - indeed, the most significant one - in negotiating a browser agreement with Microsoft." Colburn Dir. ¶ 25. The value of distribution with Windows was the "tell-tale part" of the deal, part (along with free access to valuable technology) of a "powerful one-two-...three punch" that AOL was unable to resist in its calculus of whether to do a browser deal with Microsoft. Colburn believed that the negotiations changed when Microsoft put the offer of distribution through Windows on the table because it was a "value that Netscape could not really match". Colburn, 10/28/98pm, at 32:3-18; Colburn, 10/28/98pm, at 76:21 - 77:20
- ii. Steve Case wrote in 1996 that the free valuable technology, coupled with Microsoft's "distribution (OS) muscle" gave Netscape an "uphill struggle" in negotiating a browser deal with AOL. DX 1342, at AOL M 0000190.
- iii. James Barksdale testified that, after the Microsoft agreement, Steve Case and David Colburn told him that AOL would not have entered into the agreement with Microsoft but for access to the Windows desktop. Barksdale Dir. ¶ 136.
- iv. Brad Chase confirmed that AOL saw Windows distribution as crucial: "Steve Case told Bill Gates it was important that AOL be included on the Windows desktop if there was to be a partnership between the two companies." Chase Dir. ¶ 43. During cross examination, Mr. Chase again acknowledged the importance of Windows distribution to AOL by testifying that "it would have been tougher" to get AOL to do a deal with Microsoft without giving AOL access to Windows. Chase, 2/11/99pm, at 82:18 - 83:5.
- v. At the time of the deal, Microsoft recognized that distribution with Windows was "almost an emotional thing with Case." GX 811.

236.1. Microsoft challenges Mr. Colburn's testimony that AOL would not have been willing to negotiate a browser license with Microsoft but for promotion with Windows (MPF ¶¶ 756-57, 792). But the evidence -- including statements from AOL's CEO Steve

Case and Brad Chase's own testimony -- confirms that it was Microsoft's decision to use its Windows currency that ultimately persuaded AOL to enter into a browser license agreement with Microsoft.

- i. See supra Part V.D.3.b.(4).; ¶¶ 234-236.
- ii. Microsoft itself recognized that distribution with Windows was “almost an emotional thing with Case.” GX 811. Chase confirmed that Microsoft believed Steve Case would be “passionate about trying to get into the Windows box.” Chase, 2/11/99pm, at 74:24 - 75:23.
- iii. Microsoft's own proposed findings later contradict the claim that Colburn's testimony cannot withstand scrutiny: “Microsoft understood at the time that it was important to Case that AOL receive some sort of promotion on the Windows desktop as part of any deal with Microsoft.” MPF ¶ 761 (emphasis added). Microsoft also acknowledges that “Case told Gates that AOL needed placement on the Windows desktop if there was to be a relationship between the two companies.” MPF ¶ 766 (citing Chase Dir. ¶ 42).
- iv. Chase and Silverberg made substantial efforts to convince a reluctant Gates to distribute AOL software with Windows. See, e.g., MPF ¶¶ 761-62, 766, 768-69. If distribution with Windows had not been important to AOL, then these efforts would not have made sense.

236.2. Microsoft's statement that the “March 1996 agreement between Microsoft and AOL provided for no payment from Microsoft to AOL” (MPF ¶ 767) is wrong. Although that agreement did not call for cash payments to AOL, Microsoft in fact provided substantial considerations to AOL, other than access to and use of the Internet Explorer browser, in return for distribution of Internet Explorer and exclusion of rival browsers.

- i. Microsoft itself has detailed the “value,” including the license to modify source code, technical and engineering support, and broad Internet Explorer distribution rights, that Microsoft delivered to AOL for agreeing to limit its distribution of non-Microsoft browsers and use

Internet Explorer as its preferred and default browser. See, e.g., MPF ¶¶ 793-95; supra Part V.D.3.a.; ¶¶ 225-26; supra Part V.D.3.b.(4).; ¶¶ 234-36; Chase Dir. ¶¶ 69-71; Schmalensee Dir. ¶¶ 421, 483.

ii. In addition, Microsoft and AOL entered into a subsequent contract in October 1996 that required Microsoft to give AOL cash payments for every subscriber converted to the AOL client built upon Internet Explorer, in addition to a bonus if AOL succeeded in converting a certain percentage of its installed base. Chase Dir. ¶ 79.

c. Microsoft unsuccessfully attempted at trial to minimize the value of distribution and promotion through Windows

237. Microsoft witnesses argued at trial that value of promotion through Windows was insubstantial to ISPs and OLSs, including AOL. Their testimony lacks credibility and is unpersuasive.

237.1. Bill Gates' purported lack of understanding that Windows provided a unique and valuable advertising vehicle (Gates Dep., played 12/15/98am, at 10:9 - 15:22) is not credible.

i. Gates' testimony stands in sharp contrast to his position, at the time Microsoft negotiated the AOL deal, that giving AOL placement on the Windows desktop would be "putting a bullet through MSN's head." Silverberg Dep., 1/13/99, at 703:13 - 704:19.

ii. Indeed, it was precisely the value of placement on the Windows desktop that led Gates to insist that AOL receive placement "one level below" MSN's. See supra Part V.D.3.b(2); ¶ 232.1; GX 346 (a "slight advantage" for MSN was important to Gates).

iii. Gates' testimony also stands in sharp contrast to his and others' contemporaneous writings. For example, in January 1996, Gates told AOL that the Windows box was "sacrosanct", forcing AOL's Case to find a solution in which AOL was not promoted "a la MSN". GX 38. Gates agreed with Microsoft executives who stated that Windows was a unique and valuable asset and were therefore "vehemently" against proposals to allow service providers "access to the Windows box". GX 130.

237.2. Dean Schmalensee's assertion that the "evidence shows the value that

Microsoft provided to AOL through placement in the OLS Folder was quite limited” (Schmalensee Dir. ¶ 415), is wrong.

237.2.1. First, the evidence in fact shows that both AOL and Microsoft believed that the placement AOL secured was very valuable, indeed, the “fulcrum” of the deal.

- i. See supra Part V.D.3.b.(4); ¶¶ 234 - 238.
- ii. Colburn testified that AOL’s access to Windows 95 was “more than a key part of the deal. It was the fulcrum of the deal.” Colburn, 10/29/98pm, at 34:8-11.

237.2.2. Second, Dean Schmalensee’s calculation designed to show the limited value of placement in the OLS folder to AOL (see MPF ¶ 790) is flawed.

- i. Based on the fact that AOL gets additional distribution through OEMs, and his estimate of the amount AOL paid for OEM promotion per subscriber obtained through OEMs, Dean Schmalensee calculated that the value to AOL of the placement in the Online Services folder it obtained from Microsoft was, at most, 8.3 million dollars in 1997 and 18 million dollars in 1998. Schmalensee Dir. ¶ 426. Accordingly, Dean Schmalensee reasoned, Microsoft did not incur “ a significant opportunity cost in giving AOL a place in the OLS folder.” Schmalensee Dir. E-19, ¶ 404.
- ii. Dean Schmalensee’s calculation fails to take account of the fact that AOL’s agreement with Microsoft placed it in a stronger position to negotiate deals with OEMs and, thus, that the amount AOL paid OEMs would have been much greater but for AOL’s agreement with Microsoft. Colburn, 6/14/99pm, at 87:14 - 88:7 (testifying that AOL’s agreements with OEMs

(sealed session).

- iii. Consistent with AOL’s view, Professor Fisher observed that AOL stopped paying OEMs nearly as much money after its deal with Microsoft, which suggests that the folder was valuable.” Fisher,

1/7/99pm, at 14:9-14; see also Warren-Boulton, 11/30/98am, at 65:14 - 66:17 (AOL believes it is valuable to have both placement in the OLS folder and through OEMs).

- iv. In addition, distribution with Windows allowed AOL to gain placement on computers from smaller OEMs. In an internal e-mail, AOL noted that the company was receiving “good registrations” from the Windows placement, mostly from “the bottom 25% of the PC clone market” with which “AOL will never have its own contracts for distribution”. GX 816.
- v. **Dean Schmalensee underestimates the value to AOL of placement in the OLS folder by assuming that “AOL could have obtained almost all of those additional subscribers through one of the many other distribution channels available to it” (Schmalensee Dir. ¶ 425), and that the only benefit AOL receives from placement in the OLS folder is a decrease in the cost of acquiring new subscribers. Schmalensee Dir. ¶ 426. In fact, however, AOL believed “that these are indeed incremental registrations derived from the bottom 25% of the PC clone market. This segment of the PC industry numbers in the hundreds and even thousands of disparate manufacturers which AOL will never have its own contract for distribution.” GX 816.**

237.2.3. Microsoft’s argument that its guaranteed distribution through Windows must not be all that valuable because AOL has numerous agreements with OEMs for prominent placement (Chase Dir. ¶ 31; DX 2162) is additionally flawed because it fails to recognize the enormous power that Microsoft itself has over the OEMs.

- i. AOL believed that its contracts with OEMs hold the potential to become endangered if Microsoft imposes further restrictions on OEMs. As Colburn observed, “Microsoft had a lot of power and clout with OEMs,” including the ability to “raise the ante of what would have to be spent” to secure AOL’s relationships with OEMs and the “ability to preclude” AOL from the desktop altogether. Colburn, 10/28/98am, at 27:6 - 28:7.

237.3. Microsoft’s argument that distribution with Windows was unimportant to

AOL because AOL had already achieved placement on a large number of OEM machines (MPF ¶¶ 779, 787, 789-91) is wrong.

- i. **Distribution with Windows was very valuable to AOL, regardless whether AOL achieved additional distribution elsewhere, because Microsoft used Windows to distribute MSN. See supra Part V.D.3.b.(4).; ¶¶ 234-235.**
- ii. **Distribution with Windows was valuable to AOL because it gave AOL increased bargaining leverage with OEMs. See supra Part V.D.3.c.; ¶ 237.2**
- iii. **Distribution with Windows was valuable to AOL because it allowed AOL to gain users that it was not able to gain through OEM contracts. See supra Part V.D.3.c.; ¶ 237.2.2.**
- iv. **Distribution with Windows was valuable to AOL because Microsoft has substantial influence over OEMs and the software that they load. See supra Part V.D.3.b.(4).; ¶¶ 234-36, 237.2.**
- v. **Indeed, Microsoft itself points out that AOL paid OEMs for placement on the Windows desktop, evidencing the value of Windows as a distributional mechanism. See MPF ¶ 780; see supra Part V.D.3.c.; ¶ 237.**

237A. In any event, the exclusionary effect of Microsoft's agreements with OLSs does not depend upon the "currency" Microsoft used to induce OLSs and, in particular, AOL, to enter into those agreements.

- i. **Microsoft concedes this: "AOL's reasons for choosing Microsoft are not relevant to the question of whether the agreement between AOL and Microsoft is exclusionary." MPF ¶ 772.**
 - d. **Microsoft's assertion that its lacks monopoly power over software distribution is immaterial**

238. Microsoft witnesses argued that plaintiffs failed to show that Microsoft had a monopoly

over “software distribution” with which it was able to coerce ISPs and OLSs to acquiesce to Microsoft’s terms (Schmalensee Dir. ¶ 345; Myhrvold Dir. ¶ 82; see also MPF ¶¶282-88). But whether Microsoft has a monopoly over “software distribution” does not matter.

238.1. Whether Microsoft had monopoly power over software distribution has nothing to do with whether the exclusionary restrictions in the ISP and OLS agreements were anticompetitive. They were anticompetitive because they served no legitimate purpose and erected barriers to successful distribution of browsers by Microsoft’s rivals.

- i. Professor Fisher and Dr. Warren-Boulton testified that Microsoft’s agreements were predatory and anticompetitive because the restrictions Microsoft extracted lack justification. Fisher, 6/1/99am, at 60:15 - 62:2 (the restrictive provisions in Microsoft’s ISPs contracts are not profitable absent Microsoft’s interest in maintaining its operating system monopoly); Warren-Boulton Dir. ¶¶ 182-183 (testifying that Microsoft’s restrictions on the ability of ISPs to promote and distribute Internet browsers are unrelated to any efficiency purpose and that any legitimate efficiency purpose could be accomplished by substantially less restrictive means).
- ii. The immense sums Microsoft bartered and spent to gain preferential distribution for Internet Explorer can be explained only as a predatory strategy to protect Microsoft’s operating system monopoly. See infra Part V.G.2; ¶¶ 299.4.

238.2. Microsoft needed, not monopoly power over OLSs and ISPs, but only the ability to pay valuable consideration (like desktop placement and cash) to induce the ISPs and OLSs to agree to these anticompetitive terms.

- i. Professor Fisher testified that whether or not Microsoft has economic power over software distribution “has very little to do, if any, with the case.” Instead, he explained, the critical issue is Microsoft’s monopoly power in “the area of operating systems for P.C.’s.” Fisher 6/1/99am, at 24:17 - 25:17.
- ii. Instead, Microsoft paid (rather than coerced with monopoly power over software distribution) the ISPs to agree to exclusionary terms. Dr. Warren-

Boulton testified: Microsoft was aware of the value OLSs placed on desktop placement (in the online service folder) and “sought to exchange this valuable asset for exclusionary restrictions.” Warren-Boulton Dir. ¶ 102.

- iii. David Colburn confirmed that Microsoft offered AOL value, including promotion through Windows, which was “of immense value to AOL.” Colburn Dir ¶ 24.

238.3. To be sure, Microsoft used its operating system monopoly to prevent OEMs from deleting either the Internet Connection Wizard or Online Services Folder, or superceding them with auto-loading alternative shells, and thereby enhanced the value of placement on the Windows desktop.

- i. See supra Part V.C.2.a(1); ¶¶ 177.3 - 177.3.1.4.

- e. **Microsoft’s contention that it simply offered ISPs and OLSs a better product is erroneous and misplaced**

239. Microsoft witnesses argued that access providers agreed to favor Internet Explorer and disfavor rivals merely because Microsoft “out competed” Netscape by offering a better product than Netscape. Chase Dir. ¶ 136 (arguing that the “increasing popularity of Internet Explorer is largely attributable to Microsoft’s improvements in technology”); Myhrvold Dir. ¶ 122 (testifying that Microsoft “succeeded because of the work undertaken by our developers which resulted in the technical superiority of Internet Explorer 3.0”); Myhrvold Dir. ¶ 126 (“ISPs ultimately started embracing Internet Explorer because it met their needs better than Netscape’s Web browsing software”); **MPF ¶ 784 (supposed initial AOL concerns about Netscape’s browser architecture); see also MPF ¶ 270**). But this argument (**MPF ¶¶ 764, 774, 777, 784, 785**) is inconsistent with the evidence and ultimately beside the point.

- 239.1. First, the evidence shows that Internet Explorer was not superior to Netscape

at the time Microsoft extracted its exclusionary agreements and is not clearly superior today.

239.1.1. AOL viewed both browsers as “comparable” and understood, when it entered into the March 1996 browser contract with Microsoft, that Netscape was prepared to create a browser that would have been “essentially indistinguishable” from the componentized Internet Explorer.

- i. Steve Case told Bill Gates, in January 1996, when AOL first began considering entering into a restrictive agreement with Microsoft, that he viewed Internet Explorer “technically as behind Netscape.” GX 335
- ii. David Colburn testified that, within AOL, both Netscape Navigator and Internet Explorer were viewed as “comparable.” Colburn Dir. ¶ 33. Although Internet Explorer was componentized, Netscape had a “robust browser that had been tested in the marketplace,” and had “more and better features.” Colburn Dir. ¶ 33. At the time of Microsoft deal, Netscape was viewed as the technical leader by the industry. Colburn, 10/28/98am, at 59:20 - 61:9.
- iii. AOL understood that, in 1996, Netscape was contractually committed to create, and prepared to create, a componentized browser for AOL. Colburn Dir. ¶ 34; James Barksdale told AOL that Netscape was prepared to do “whatever they needed to do” to integrate their browser with the AOL client. Colburn, 10/28/98pm, at 18:3 - 19:11; Barksdale, 10/26/98am, at 57:9-25. Indeed, AOL believed that by the time AOL would have been ready to use a browser in its next software release, Internet Explorer and Netscape Navigator would probably be “essentially indistinguishable.” Colburn Dir. ¶ 33.
- iv. Netscape had made a commitment to meet AOL’s delivery schedule. Barksdale, 10/26/98am, at 58:2-3. As Mr. Barksdale testified: “It’s not rocket science to do it. We were willing to do it, and knew how to do it, and offered to do it.” Barksdale, 10/26/98am, at 59:12-13. After AOL entered into a virtually exclusive agreement with Microsoft, however, Netscape had little incentive to rapidly develop a componentized browser for AOL. Barksdale, 10/26/98am, at 67:22 - 68:11. Without a guarantee of at least some distribution by AOL, quick development of a componentized browser made little economic sense.

DX 1733, at AOL M 0001025; Colburn, 10/28/98pm, at 63:17 - 64:6; Colburn, 10/29/98am, at 30:14 - 31:13; Colburn, 10/29/99pm, at 35:10-20.

239.1.2. After its agreement with Microsoft, it became even more apparent that Internet Explorer was not materially superior to Netscape Navigator, as AOL had continuing complaints about Internet Explorer.

- i. The time it took Microsoft to develop a componentized cross-platform browser was a problem for AOL. Colburn, 10/28/98am, at 60:15-61:9.
- ii. In August 1997, AOL believed that the “IE4 browser is huge and is tangled up with OS in Win98 product.” Netscape Navigator, on the other hand, was cited for having a “Much Smaller Disk Footprint.” GX 818.
- iii. Following a technical meeting with Netscape, AOL noted that Netscape’s browser would take only about 4-6 months to componentize, shipped with functional parity on all platforms, and had lower memory requirements and more ease-of-use features than Internet Explorer. GX 1150.
- iv. Colburn testified that Internet Explorer hardly got a “ringing endorsement” from AOL. Colburn, 10/28/98pm, at 21:16 - 22:10.

239.2. Second, Microsoft’s argument that access providers chose Internet Explorer because it was “better” than Netscape Navigator is inconsistent with the restrictions on distributing other browsers that Microsoft imposed.

- i. Microsoft required access providers to restrict their distribution of Netscape Navigator (rather than to merely promote Internet Explorer). Fisher, 6/1/99am, at 66:18-25.
- ii. Cameron Myhrvold admitted that the distribution restrictions resulted from a fear that, if provided a “side-by-side” choice of Internet Explorer and Netscape Navigator, users would choose Netscape Navigator. Myhrvold, 2/10/99am, at

62:7 - 64:20.

239.3. Third, Microsoft's argument is also inconsistent with the evidence that, absent promotion through Windows, AOL would not have accepted Microsoft's exclusionary terms.

i. See infra Part V.D.4.b.(4); ¶ 255.

239.3A. Microsoft cites Mr. Case's public statements made when the agreement was announced about the benefits of using Microsoft technology (MPF ¶ 777). On the very same day, however, Case also told reporters that Microsoft's willingness to build AOL access software into Windows was a key part of the AOL deal with Microsoft.

i. **GX 1300.**

239.4. Dean Schmalensee's contention that AOL (and other OLSs and ISPs) agreed to Microsoft's terms because the total aggregation of value Microsoft offered -- including Internet Explorer -- was large (Schmalensee Dir. ¶¶ 421, 483) is merely another way of saying that Microsoft spent a lot to obtain its exclusionary terms.

4. Microsoft's agreements have caused substantial competitive harm

240. As it anticipated, Microsoft's agreements had, and continue to have, a substantial exclusionary impact. Microsoft's restrictions prevented access providers from meeting consumer demand by providing another browser (which would likely have been pre-configured for the service) and made it difficult for users to locate and install another browser. The result of Microsoft's exclusionary restrictions was substantially to increase Internet Explorer's browser market share, diminish rivals' market share, and facilitate Microsoft's maintenance of its operating system monopoly.

a. Microsoft's agreements raised rivals' costs

241. Microsoft's restrictive agreements substantially raised the costs to rivals of obtaining and retaining browser market share.

241.1. Microsoft's requirement that ISPs and OLSs distribute and promote only Internet Explorer (or mostly Internet Explorer) hindered browser rivals because users, in particular novice users, tend to use the browser supplied by their access provider.

- i. A 1996 ISP marketing update stated that ISPs are important to Microsoft's "Internet mission" because most new users are first exposed to the Internet through their ISP and if users get the IE set-up to work with their ISP, they will be "less likely to switch to Netscape or another browser later." GX 93.
- ii. Even Dean Schmalensee conceded that "AOL customers and the customers of online services use the browsing software provided by their online services." Schmalensee, 1/19/99pm, at 62:20 - 63:6.
- iii. In a testament to an ordinary user's lack of initiative in changing the software as received from the original source, William Harris testified that "... it is generally understood in the computer industry, that consumers have a high proclivity to accept default settings and configurations on software and computer-based services." Harris Dir. ¶ 92.
- iv. See infra Part VII.A.2.c.; ¶ 366.

241.2. This is particularly true of AOL users.

241.2.1. A large segment of AOL users are novices who are especially likely not to switch browsers once presented with the AOL client built on Internet Explorer.

- i. GX 814A ("the typical AOL user is an Internet novice"); GX 1062, at page 2 (AOL study entitled "AOL Web Browser Usability Test" concluding that "the most alarming fact discovered in the Novice group is that most do not know the difference between being on AOL and being on the Internet. Those Novice users thought that once they signed on to AOL, they had already accessed the Internet."); GX 415, at MSV 10566 (only three percent of AOL's users in 1997 considered themselves "advanced" Web surfers, compared to thirteen percent of

Navigator's users and twenty-five percent of Internet Explorer's).

- ii. Colburn testified that users tend to use the software provided by AOL. He believes that AOL's users use Internet Explorer because AOL has "virtual exclusivity" with Microsoft. Colburn, 10/28/98am, at 56:14-22.
- iii. Colburn also stated that a user would have to be "technically savvy" to understand the process for using Netscape Navigator with the AOL service. Colburn, 10/28/98am, at 46:15 - 47:8.
- iv. Brad Chase, upon announcing the AOL/Microsoft deal, confirmed that users will not be "faced with an either/or choice" of browsers. Instead Internet Explorer would be "the standard choice" for all customers. Although AOL users are permitted to download Navigator, this option will not be displayed "in a prominent way" and "for all intents and purposes... AOL will be moving its 5M customers to a new client integrated with Internet Explorer 3." GX 180.

241.2.2. Moreover, after AOL signed its agreement with Microsoft to "exclusively promote, market, and distribute" Internet Explorer, AOL's users were "force fed" Internet Explorer. Even if a user continued using another browser, the user was prompted to take Internet Explorer every time the user attempted to sign off AOL.

- i. The share of AOL subscribers with the latest version of Internet Explorer installed on their machines rose to over 90% after AOL signed its agreement with Microsoft. Microsoft executives attributed this rise to the fact that AOL -- in Microsoft's own words -- "force fed" Internet Explorer to AOL users by automatically distributing Internet Explorer to users each time a user attempted to log off AOL. AOL also used what Microsoft called the "deadline approach," in which users who had an older browser version could not enter the AOL service unless they downloaded the latest browser version or upgraded using CD sent in the mail. GX 814A.
- ii. In December 1996, less than nine months after AOL signed its agreement with Microsoft, Bill Gates wrote that Microsoft had little incentive to negotiate with AOL to include the OLS as a default channel on the Windows desktop because "we are getting all their users for IE through other efforts." GX 346.

241.3. Even for users inclined to try-out another browser, Microsoft's restrictions raised rivals' costs because users are unlikely to bear the (largely non-monetary) costs of successfully obtaining a browser through other channels and then attempting to configure it for their ISPs/OLSs service.

- i. David Colburn testified that getting another browser for AOL requires some "complex steps" and "technically savvy" users. Colburn, 10/28/98am, at 46:15 - 47:7. Colburn believes that it is "difficult" for AOL's customers to obtain and use Netscape Navigator. Colburn, 10/29/98pm, at 66:7 - 67:6.
- ii. Cameron Myhrvold testified, regarding Southwestern Bell's (an ISP that does not have a restrictive contract with Microsoft) offering of Netscape through its web site, that, although obtaining and installing Internet Explorer through SBC's web site might be "technically possible," it is not "very attractive to have to go in and manually configure it and then be followed by a note that says you're not going to get any technical support." Myhrvold, 2/10/99pm, at 81:5 - 82:8.
- iii. Myhrvold also testified, in referring to Internet Explorer's difficulties before Microsoft required its distribution as the default browser, that "in many cases, even if a user had acquired Internet Explorer on his own, he would not receive any help from the ISP in configuring Internet Explorer for the ISP's service." Myhrvold Dir. ¶ 26.
- iv. See also infra Part VII.A.2.c.; ¶¶ 366.2-.4.

241.3A. Microsoft was well aware because of its own difficulty obtaining distribution through ISPs that had only minimum commitments with Netscape (rather than terms prohibiting the distribution and promotion of rival browsers), that its restrictions would make it more difficult for Netscape to maintain distribution. See, e.g., MPF ¶ 716.

b. Microsoft's contracts substantially excluded rival web browsers

242. The impact of Microsoft's efforts to raise rivals' costs was to garner substantial browser market share at rivals' expense. Microsoft's internal documents and the testimony of its witnesses, the

AdKnowledge data, and Internet Explorer's comparative lack of success in channels where Microsoft has not secured exclusionary agreements — all prove the exclusionary impact of Microsoft's agreements.

(1) Microsoft's internal analyses evidence the impact of its restrictions

243. Microsoft's internal documents show that obtaining preferential distribution through ISPs and OLSs had a significant impact on Internet Explorer's usage and substantially increased Internet Explorer's market share.

- i. Microsoft concluded that its agreement with AOL (and its CompuServe subsidiary) alone tied up 65% of the subscribers considered to be in the "Top 80" access providers by the end of 1997. GX 835, at MS98 0112834 (cited in Fisher Dir. ¶ 216).
- ii. Microsoft further reported in January 1998 that "IE share" on AOL GX 424, at MS7 000591 (sealed); This is consistent with AOL's own estimate that, as of January 1998, the "current share" of Internet Explorer on AOL was "90+". Microsoft executives commented that such a high browser share would "really change the way we work with AOL; there are few users left to upgrade, so we don't need to keep beating them up about this." GX 814A.
- iii. As of December 1997, Microsoft estimated that Internet Explorer had a "run rate" of 76% of the referral server ISPs. GX 425, at MS98 0102442. During this same period, another Microsoft document stated that 10 of the top 12 ISPs ship IE4 today" and "63% overall ship IE default". GX 1063, at 10.
- iv. By January 28, 1998, Microsoft believed that Internet Explorer's share among the top ten ISP/OLSs (GX 427, at MS98 0116511) (sealed) and that 85 of the top 100 access providers shipped Internet Explorer as their preferred or exclusive browser. GX 420, at MS98 0113045.
- v. Professor Fisher summarized Microsoft's own calculation of the impact of Microsoft's restrictions on ISPs: "According to a Microsoft document, at year end 1997 Microsoft enjoyed a 94 percent weighted average share of browser shipments by ISPs who agreed to make IE their default browser, compared with a 14 percent weighted average share of browser shipments by ISPs who did not make IE their default browser.

Microsoft's weighted average share of browser usage by subscribers to ISPs who made IE their default browser was over 60 percent; Microsoft's weighted average share of browser usage by subscribers to ISPs who did not make IE their default was less than 20 percent." Fisher Dir. ¶ 224 (referring to GX 366); see also GX 11.

vi. Microsoft noted in a May 1997 e-mail entitled “

GX 823 (emphasis in original) (sealed).

(2) The exclusionary impact of Microsoft's agreements is confirmed by the AdKnowledge data

244. Data collected by a company called AdKnoweldge confirms that Microsoft's exclusionary agreements with ISPs and OLSs have had a substantial impact on Internet Explorer's market share.

245. AdKnowledge collects hit data, which measures the intensity with which a particular browser is used and is the most relevant metric of market share in this case.

245.1. AdKnowledge collects “hit” data and measures intensity of use.

- i. Adknowledge is a company that markets web advertising management services and as part of that service uses a set of servers that delivers web page advertisements when users request particular webpages. Warren-Boulton Dir. ¶ 145; Fisher Dir. ¶ 225
- ii. As part of its ordinary activities, Adknowledge collects information on which browsers call up a particular web page containing banner ads “served” by AdKnowledge. In the language of the industry, Adknowledge tracks the number of “ads served” and its data is commonly referred to as “hit data.” Gildor Dep., 10/6/98, at 31:11 - 32:8 (DX 2569); Warren-Boulton Dir. ¶145; Fisher Dir. ¶ 225.
- iii. As part of tracking the hit data, AdKnowledge records information on the type of browser being used and on the user's “domain name,” which in certain cases can be used to determine the user's ISP. Warren-Boulton Dir. ¶ 145; Fisher Dir. ¶ 225.

- iv. Dean Schmalensee conceded that hit data, such as the AdKnowledge data, measures the intensity with which a particular browser is used. Schmalensee Dir. App. ¶ 44.

245.2. Intensity of use, as will be explained, is the most appropriate measure of market share in this case.

- i. See infra Part VII.A.1.; ¶¶ 360.1-.2.
- ii. Professor Fisher testified that it is appropriate to measure browser share as ISVs would assess it for the purposes of determining to which platforms to develop applications. Fisher, 6/1/99pm, at 20:13 - 22:8.

246. The AdKnowledge data, as Professor Fisher and Dr. Warren-Boulton testified, show a broad increase in the usage of Internet Explorer, and decline in usage of Netscape, over the time period in which Microsoft engaged in its exclusionary practices.

- i. The AdKnowledge data show that Internet Explorer's overall market share increased from approximately 20% in January 1997 to 49% by August 1998. See infra Part VII.A.3; ¶ 369.1.1.
- ii. The AdKnowledge data show that Netscape's usage share declined from 77% to 48% over the same period. See infra Part VII.A.3; ¶ 369.1.1.

247. The AdKnowledge data also demonstrate the substantial impact of Microsoft's exclusionary agreements. Plaintiffs' economists estimated this impact by comparing the share of browsers used by subscribers of access providers that signed restrictive agreements with Microsoft (such as AOL) with the share of browsers used by subscribers of access providers that did not sign restrictive agreements.

247.1. Plaintiffs' economists compared several categories of ISPs that were parties to agreements with Microsoft or Netscape which required varying degrees of preferential treatment for

Internet Explorer or Netscape, against a control group consisting of a set of ISPs that had no contractual obligations to either Microsoft or other browser manufacturers:

- i. Plaintiffs' economists assembled data for several categories of ISPs. The categories included (1) AOL (along with its subsidiary, CompuServe); (2) a category Microsoft described as "IE Preferred"; (3) a category consisting of all hits recorded by AdKnowledge including all hits from ISPs, OLSs, and other firms that provide Internet access; (4) a category of ISPs whose shipments of rival browsers was contractually limited by Microsoft to a certain percentage of overall shipments ("shipment restrictions"); and (5) a category consisting of "Netscape Partners," ISPs (principally the Regional Bell Operating Companies called the RBOCs) that have granted Netscape certain preferences. Warren-Boulton, 12/1/98pm, at 17:17 - 18:7.
- ii. These categories were compared against a control group of ISPs that were not subject to contractual restrictions. The control group is called in Microsoft's documents "IE parity" and is distinguished in those documents from two other groups that Microsoft describes as "IE Preferred" and "Netscape Preferred." GX 835, at MS98 0112826.

247.2. Through two sets of comparisons, plaintiffs' economists demonstrated that Microsoft's ISP and OLS agreements had a substantial exclusionary impact.

247.2.1. First, Professor Fisher and Dr. Warren-Boulton demonstrated that Internet Explorer's overall share rose far more sharply -- by approximately 20% -- than Internet Explorer's share among users of ISPs that were not subject to Microsoft's contractual restrictions.

- i. Internet Explorer's overall share of browsers rose from 20% in January 1997 to 49% in August 1998, while Netscape's share fell from 77% to 48%. GX 4, GX 5, GX 1445, GX 1480; Warren-Boulton Dir. ¶ 146; Fisher Dir. ¶ 228. By contrast, Internet Explorer's share of usage among subscribers of the control group ISPs rose only from 20% to 30% over the same period. GX 3; GX 5; GX 1445; GX 1480; Warren Boulton Dir. ¶¶ 144, 149; Fisher Dir. ¶ 228.
- ii. This difference led Dr. Warren-Boulton to conclude that, "[i]f no ISPs had been party to exclusionary agreements, assuming no other changes,

it is reasonable to expect that IE's market share would be its share of customers of these unconstrained ISPs -- approximately 30 percent in August 1998. The differences between that share and IE's actual overall share -- 49 percent -- shows the impact on the market of the Microsoft ISP agreements." Warren Boulton Dir. ¶ 150; see also id. ¶151 (explaining that the dramatic difference between AOL's share and overall share cannot be explained by factors other than the contractual restrictions).

247.2.2. Second, Professor Fisher and Dr. Warren-Boulton showed that

Internet Explorer's share of usage among ISP users increased as the ISP's contractual obligations to favor Internet Explorer became more severe. This is precisely, they explained, what one would expect if Microsoft's agreements had exclusionary effects.

- i. Dr. Warren-Boulton prepared a chart based on the AdKnowledge data showing the change in Internet Explorer's share among the various categories of ISPs (the 5 listed above) over the same time period. GX 1318. That bar graph shows that, the more exclusionary the terms of Microsoft's contracts, the greater the increase in Internet Explorer's share. GX 1318.
- ii. Dr. Warren-Boulton testified that the striking correlation between Internet Explorer usage share and the degree of contractual restrictions on promoting and distributing browser rivals is precisely what one would expect if the agreements had a substantial exclusionary impact. Warren-Boulton, 12/1/98pm, at 17:17 - 18:7.
- iii. Professor Fisher also demonstrated, in results he described as "striking," that more severe contractual restrictions correlated with higher Internet Explorer share. Fisher Dir. ¶ 228. Professor Fisher undertook a comparison similar to Dr. Warren Boulton's, but using only three categories of ISPs: (1) AOL/CompuServe; (2) all ISPs; and (3) the "parity" control group. GX 4. Professor Fisher's analysis showed that, while Internet Explorer's share of the Internet Explorer Parity "control group" rose less than 10% in the relevant period, Internet Explorer's share of the "All ISP" group increased nearly 30%. The share increase in the Internet Explorer parity group, as Professor Fisher testified, includes changes in share due to Internet Explorer's increased quality

(and other factors, such as Microsoft's other exclusionary conduct). Accordingly, the 20% difference between the "All ISP" group and the control group reflects the impact of Microsoft's restrictive agreements on Internet Explorer's overall market share. Fisher Dir. ¶¶ 227-228; GX 4; GX 1445.

247.3. The AdKnowledge data also show that the impact of Microsoft's exclusionary contract with AOL was especially severe.

- i. Internet Explorer's share of AOL -- which had the most restrictive agreement with Microsoft -- rose 60% (from 25% in the first three months of 1997 to 85% in June, July, and August of 1998), while Internet Explorer's share of usage on ISPs that were contractually neutral rose less than 10%. GX 1318.
- ii. While Internet Explorer's share of the parity group increased only 10% from January 1997 to August 1998, Internet Explorer's share of AOL and CompuServe users rose from 22% to 87% during the same period, and its share for all ISPs rose from 22% to 49%. Fisher Dir. ¶ 228; GX 4; Warren Boulton Dir. ¶ 148.

247.4. The degree of anticompetitive impact Professor Fisher and Dr. Warren-Boulton found based on their analyses of the AdKnowledge data is, if anything, conservative because the control group itself consists of ISPs affected by Microsoft's other predatory and anticompetitive conduct, such as its bundling of Internet Explorer and predatory pricing.

- i. Dr. Warren-Boulton testified: "Moreover, differences between the IE parity group and the other groups, if anything, understate the exclusionary impact of Microsoft's practices because the IE parity itself may have been affected by Microsoft's exclusionary conduct." Warren-Boulton Dir. ¶ 151; see also Warren-Boulton, 12/1/99pm, at 38:1-6 (explaining that the control group may have been affected by several of Microsoft's anticompetitive practices, such as the OEM tying).
- ii. Professor Fisher also testified that caching leads to an "understatement of the effects of Microsoft's restrictive practices." Fisher Dir. ¶ 226, n.6.

247A. Microsoft's argument that its AOL contract was not exclusionary because 22%

of AOL users purportedly used Navigator as their primary Web browsing software as of the third quarter of 1998 (MPF ¶¶ 757; 802) is based on flawed data and is contradicted by the more reliable AdKnowledge data.

- i. **See infra Part VII.A.5.b.(3).; ¶ 377.2 (detailing the flaws in the MDC data set that make this particular percentage unreliable).**
- ii. **The AdKnowledge data show that Navigator’s usage share among AOL users is approximately 12%. Schmalensee Dir. App. D. Tbl. D-8. That Navigator usage share among AOL users is 12% is consistent with AOL’s contract, which limits shipments of non-Microsoft browsers to less than 15% of its total browser shipments.**

(3) The exclusionary impact of Microsoft’s agreements is confirmed by Internet Explorer’s comparative lack of success in other channels

248. Internet Explorer has not fared as well in channels that are not subject to Microsoft’s exclusionary agreements or control. As partly illustrated by the AdKnowledge data, Internet Explorer has a lower share in unconstrained distribution channels.

- i. Microsoft itself refers to the unconstrained channels as “demand driven.” GX 807. **See also MPF ¶ 313.**
- ii. Cameron Myhrvold conceded that Internet Explorer does not do as well in the retail channel, where Microsoft does not have restrictive agreements, as it does when distributed through ISPs and OEMs. Myhrvold, 2/10/99am, at 32:8-21.
- iii. Microsoft repeatedly pointed out during the trial that Netscape has a higher market share among corporate and educational customers. Defendant’s Opening, 10/20/98am, at 29:25 - 30:12. Dean Schmalensee cited a Zona research study of the browser market (DX 60) to argue that “Netscape continues to have a large share of corporate users.” Schmalensee Dir. ¶ 538. A 1997 marketing memo from Brad Chase wrote that “We have not done a very good job with this segment...Netscape still has this lead on us.” GX 512, at MS7 004152.

- iv. James Barksdale agreed that Netscape has a relatively large share of corporate and enterprise users and testified that: “That proves the point I am making... where we have more access to the market, we are doing much better than where we have been estopped from half of the distribution channels... When we get to compete head to head, we do pretty good.” Barksdale, 10/26/98pm, at 45:6 - 47:19.
 - v. Users of Internet browsing software downloaded Netscape’s browser almost 2.5 times as often as Internet Explorer in both the first and third quarters of 1998. GX 1845; GX 1846 (estimating the download figures for Netscape and Microsoft at 6.7 million and 2.7 million respectively in 1Q98 and 6.7 million and 2.8 million in 3Q98).
 - vi. See also infra Part VII.A.
- c. Microsoft’s arguments that its ISP and OLS agreements did not have a significant exclusionary impact are belied by the evidence**

249. Microsoft witnesses advanced various arguments to the effect that its ISP and OLS agreements did not substantially affect browser market share. The arguments are unsound and, in many instances, incredible.

(1) Microsoft’s restrictions were not ineffective

250. The testimony of Microsoft’s witnesses that its restrictions were benign is at odds with the facts and misleading.

250.1. First, contrary to the contention of its witnesses, Microsoft’s contractual restrictions had a significant impact on the ISPs and OLSs that were parties to them.

250.1.1. Cameron Myhrvold asserted that, under their agreements with Microsoft, ISPs and OLSs could “provide customers with whatever Web browsing software the customer requested” and were “never required to distribute IE to any specified percentage” of users. Myhrvold Dir. ¶ 5 (emphasis in original). But he could not defend this assertion.

- i. Myhrvold admitted (as is clearly spelled out in the plain language of the

contracts themselves) that if, an ISP fell below the shipment percentage, Microsoft had the contractual right to remove it from the Internet referral server. Myhrvold, 2/10/99am, at 51:11 - 52:21; 53:14-18.

- ii. See also GX 1144, at MS6 5001130 (Microsoft and Spry, Inc. Internet Sign-Up Wizard Referral Agreement, § 3.1) (sealed); GX 1146, at MS6 5000924 (Microsoft and Mindspring Internet Sign-Up Wizard Referral and Microsoft Internet Explorer License and Distribution Agreement, § 3.1) (sealed); GX 1213, at MS6 5000388, -389 (Microsoft and AT&T Promotion and Distribution Agreement, §§ 3.3 and 4.1) (sealed); GX 804, at AOL 0001735, -738, -740 (Microsoft and AOL License and Marketing Agreement, §§ 6.1, 7.2, and 7.4).

250.1.2. Similarly, Brad Chase misrepresented the terms of Microsoft's contract with AOL when he testified that "AOL has always been free to provide non-Microsoft browsing software to subscribers who request it." Chase ¶ 73 ; **See also MPF ¶ 797** This testimony is at odds with the explicit terms of Microsoft's contract with AOL.

- i. Chase himself admitted that Microsoft's agreements "limit the ability of the OLSs to promote and distribute non-Microsoft Web browsing software." Chase Dir. ¶ 98. And he wrote at the time of the contract that the exceptions allowing AOL to use another browser were "pretty remote." GX 180.
- ii. AOL (like other ISPs/OLSs) had to abide by shipment restrictions that prohibited it from distributing other browsers more than a certain percentage. Fisher, 6/1/99am, at 65:24 - 66:25 (testifying that Microsoft does not merely require ISPs to ship Internet Explorer to a certain percentage of its subscribers; instead, Microsoft prevents the ISPs from shipping more than a certain percentage of non-Microsoft browsers to its customers).
- iii. Colburn testified that, during the negotiations (in which Chase was involved), Microsoft "attempted to secure exclusive distribution and promotion for Internet Explorer, with no or few exceptions for distribution or promotion of a competitive browser Microsoft obtained virtual exclusivity for its browser on AOL, preventing AOL from providing any significant promotion or distribution of Netscape's

Navigator browser.” Colburn Dir. ¶ 28. In addition, among other restrictions, AOL’s contract with Microsoft prohibited it from volunteering information to its members about how to download Netscape Navigator. Chase, 2/11/99pm, at 46:11 - 47:6; 56:21 - 57:9.

250.2. Second, contrary to the assertion of Microsoft’s witnesses (Chase Dir. ¶ 167), downloading is not an efficient channel of distribution for web browsers.

250.2.1. The video tape that Brad Chase sponsored to show the supposed ease with which users may download Netscape Navigator from AOL (DX 2162) does not accurately represent the experience of an end user attempting to obtain, install, and use Netscape Navigator with AOL.

250.2.1.1. *First*, Chase’s video skipped the entire browser installation process.

- i. Compare GX 1665 (a videotape prepared by the plaintiffs demonstrating the download and installation steps that Chase’s videotape skipped) with Chase, 2/11/99am, at 25:24 - 26:3.

250.2.1.1.1. That process requires additional complex steps, knowledge, and a significant amount of time, during which, as Chase admits, many things may occur to cause the user to lose his connection.

- i. Chase testified that there are any number of problems that one may encounter while downloading a browser, with disconnection of the phone line the most common. Chase, 2/16/99am, at 37:9 - 38:3.

250.2.1.1.2. Brad Chase’s video omits the following steps and ignores the following problems:

- i. After the user clicks on the button to make the

“Download Manager” screen appear on AOL, there are no instructions telling the user what to do next. Chase, 2/16/99am, at 31:8-14.

- ii. And after the download process is complete and the user clicks “Okay” to return to the AOL service, Netscape Navigator does not appear anywhere on the screen. Nor do appear any instructions. The user must know that the next step is to find the downloaded file and execute it. Chase, 2/16/99am, at 35:25 - 36:12.
- iii. In order to find the download file, a user must exit AOL altogether, “minimize” the AOL service screen, or “navigate to the explorer and explore through the files to go to the download folder.” Chase, 2/16/99am, at 39:14 - 41:1. There are no instructions telling the user what to do, or even that anything additional needs to be done. Chase, 2/16/99am, at 39:14 - 41:1.
- iv. Once the user locates the “My Computer” file, the user must find the file setup.ex. The user has to remember where AOL put this file in the earlier download manager screen, approximately 45 minutes earlier. Again, there are no instructions for the user to follow. Chase, 2/16/99am, at 42:6 - 43:11; GX 1665.
- v. In short, the plaintiffs’ videotape confirmed, as Chase himself wrote in an internal e-mail, the setup process is “too hard for users to figure out. Only a little more than half of the people that download active set-up end up installing the browser. I think they don’t figure out what to do once they download the set-up stub.” GX 214.

250.2.1.2. *Second*, for the video, Microsoft used a high speed internal corporate connection. This type of connection is used only for “new corporate installations” and not by home users, which represent AOL’s customer base. With an Internet connection typically used by home users, the download process takes significantly longer than depicted in Chase’s video.

- i. Chase himself concedes that “not many” users have this type of connection. Chase, 2/11/99am, at 26:21 - 27:11.
- ii. The download time (not counting the installation process) alone took between 30 and 60 minutes during the three trials made by the plaintiffs’ expert in filming GX 1665. Chase, 2/16/99am, at 34:7-10.
- iii. US West estimated that it would take an average of “45 minutes” for residential customers to download Netscape Communicator. Bozich concluded that it “took a long time.” Bozich Dep., 1/13/99, at 122:9 - 123:22.

250.2.1.3. *Third*, Chase acknowledged that AOL is not permitted by Microsoft’s contract to put a text message on the screen that advises users that they may download Netscape Navigator. AOL is not even permitted to tell users what key words to type into the AOL search function to locate the download site for Navigator.

- i. Chase conceded that Microsoft’s contract with AOL did not allow AOL to advise users that they may download Navigator. For instance the Microsoft does not allow AOL to put a text message on the screen telling users how to download Netscape’s browser. Microsoft had limitations on “how much AOL could promote Netscape Navigator within their service.” Chase, 2/16/99am, at 29:14 - 30:13.
- ii. Colburn testified that “we were greatly restricted under the Microsoft contract as to where we could advertise Navigator, downloads for them, whatever, and so there was relatively little place for them to get promotion.” Colburn, 10/29/98pm, at 36:7-11.

250.2.2. Mr. Chase confirmed the complexities involved in this entire process of downloading and installing Netscape Navigator from AOL when he told the Court that the explanation of that process gets “complicated.” That conclusion is supported by other evidence, in

addition to plaintiffs' videotape:

- i. Responding to the Court's question relating to an AOL user downloading Netscape Navigator, Chase testified, "This gets a little complicated, your honor. Let my try to explain. There's a series of processes that are involved here." Chase, 2/16/99am, at 25:15-17.
- ii. Mr. Myhrvold's videotape makes the point that getting a browser that is not preinstalled on the computer requires both time to acquire the browser and begin the installation and "the time and effort and knowledge needed to run the setup program, which, for a large number of users, would actually be cumbersome and not straightforward." DX 2166; Myhrvold, 2/9/99pm, at 22:13 - 23:2.
- iii. Chase agreed that, for some users, it would be "cumbersome and not straightforward to try to install the browser themselves" Chase, 2/11/99pm, at 14:7 - 16:21.

(2) Microsoft's agreements frustrated access providers' desire to offer customers a choice of browsers

251. Microsoft's witnesses argue that its agreements did not have a substantial impact because many ISPs want to offer only a single browser. (Schmalensee Dir. ¶¶ 407, 435, 436). But this argument, too, is inconsistent with the evidence.

251.1. ISPs and OLSs wanted to offer a choice of browsers in order to meet consumer demand.

- i. Cameron Myhrvold testified that most ISPs support both Netscape Navigator and Internet Explorer because "that is what their customers demand." Myhrvold Dir. ¶ 17. ISPs, Myhrvold agreed, "generally like to give their subscribers a choice of browsers." Myhrvold, 2/9/99pm, at 72:12-14.
- ii. According to an internal e-mail from Myhrvold to, among others, Brad Chase and Joachim Kempin, Myhrvold wrote it was "damn hard" for Microsoft to get ISPs to favor Internet Explorer because "ISPs are agnostic on the browser" and "it's against their nature to favor a browser." He elaborated: "I have had a hard time guiding the ISPs to IE loyalty even when I made them sign explicit terms

and conditions in a legal contract.” GX 440.

- iii. Myhrvold further testified that Microsoft imposed its shipment restrictions -- which prohibited ISPs and OLSs from offering other browsers, even to customers that requested them, if total shipments of other browsers exceeded a certain level -- precisely because Microsoft was afraid that access providers would offers users a choice. If users had a “side-by-side” choice of browsers on their merits, Microsoft believed, users would be more likely to choose Netscape. Myhrvold, 2/10/99am, at 62:7 - 64:20.

251.2. AOL wanted — but was not allowed — the flexibility to offer its users a choice of browsers.

- i. David Colburn testified that AOL wanted the flexibility to be able to integrate two different browsers into its client software, and thus provide its users with an easily accessible choice of browsers. Colburn Dir. ¶ 28 (“It was AOL’s objective to have both Navigator and Internet Explorer available to its members, allowing them to choose which browser to use.”); Colburn Dir. ¶ 26 (“AOL wanted the flexibility of being able to integrate different browsers into its client software,”); Colburn, 10/28/98pm, at 67:23 - 69:12 (AOL could have given Netscape and Microsoft’s browsers “coequal” positioning on the AOL client and thus offered consumer choice).
- ii. This is precisely why, as Colburn testified, AOL fought (unsuccessfully) not to be subjected to the restrictions. Colburn, 10/29/98pm, at 46:18 -49:18.

251.3. Brad Chase’s contrary testimony -- that AOL wanted to distribute only one browser to its users (Chase Dir. ¶ 37); see MPF ¶¶ 781-82 -- is itself contradictory and not credible:

- i. Chase said (at trial) that AOL wanted to integrate only one browser technology with the AOL client. Chase, 2/17/99am, at 55:8 - 58:16. But, when confronted with Colburn’s testimony that “AOL wanted the flexibility of being able to integrate different browsers into its client software,” Chase argued — falsely — that AOL’s contract with Microsoft permitted it to have another “AOL client alternative” with another browser if it wanted. Chase, 2/17/99am, at 58:23 - 59:11.
- ii. Although Mr. Chase testified at trial that AOL “always wanted to have one primary technology,” Chase, 2/17/99am, at 60:7-22, he testified in deposition as

follows: “I recall AOL wanted flexibility. I don’t recall whether they wanted to ship both browsers, or make available both browsers, or have one and not the other. I don’t recall.” Chase, 2/17/99am, at 61:18-21 (quoting Chase Dep., 3/25/98, at 180:17-20).

- iii. At trial, Chase said that his deposition testimony did not refer to AOL actually incorporating different browser technologies into different versions of its software. Chase, 2/17/99am, at 62:2-15. In his deposition, however, Chase testified that he would “agree that [AOL] wanted to have the flexibility” and that he didn’t “know what they really wanted to do,” Chase, 2/17/99am, at 62:16 - 63:18 (quoting Chase Dep., 9/29/98, at 185:4-8), and that he wasn’t “really sure” whether AOL would have “entered into an agreement with both Microsoft and Netscape to incorporate their browser technology in different versions of AOL’s client software.” Chase 2/17/99am, at 63:20 - 64:13 (quoting Chase Dep., 9/29/98, at 185:23 - 186:5).
- iv. On re-direct, Chase argued that he was testifying about whether AOL wanted to create one client technology and put both browsers in the same client. Chase, 2/17/99am, at 68:3 - 69:23. But, at his deposition, he was asked whether AOL wanted to incorporate Internet Explorer and Netscape “in different versions of AOL’s client software” and answered: “I certainly - I can’t say definitively.” Chase, 2/17/99am, at 70:24 - 72:6 (quoting Chase. Dep, 9/29/98, at 185:23 - 186:16).

251.4. Other access providers also wanted to give users a choice of browsers; many of them nonetheless agreed to strict restrictions on their ability to satisfy their customers’ demands in order to obtain desktop placement or other consideration from Microsoft.

- i. CompuServe agreed to Microsoft’s restrictions even though it preferred “to have flexibility in the software” that it uses. Warren-Boulton Dir. ¶ 111 (citing Knott Dep., 2/20/98, at 24:24 - 25:5).
- ii. MCI also suffered from not being able to provide browser choice: “There are certainly users out there that prefer browsers and e-mail clients that are not Microsoft. And our ability to reach them and entice them to sign up for our service is presumably enhanced by the ability to promote and distribute those.” Warren-Boulton Dir. ¶ 111 (quoting Von Rump Dep., 4/28/98, at 16:25 - 17:4). Because Netscape Navigator was the more popular browser, MCI tried to negotiate less stringent restrictions with Microsoft. Von Rump Dep., 1/13/99,

at 327:19 - 328:6. MCI was, however, unsuccessful. Von Rump Dep., 1/13/99, at 326:13 - 327:10.

- iii. Robert Beran, head of Bell Atlantic's ISP service (BAIS), testified that BAIS chose to sign an agreement for promotion through Netscape's referral server rather than Microsoft's because the restrictions on which Microsoft insisted -- exclusivity for Internet Explorer -- were too onerous. The exclusionary provisions in the Microsoft agreement did not allow Bell Atlantic to meet its objective of letting "the customer choose which browser they wanted to use" which Bell Atlantic viewed as part of its "job to provide customers with access to the leading browsers". Beran Dep., 1/13/99, 117:19 - 120:15; see also Beran Dep., 1/13/99, at 117:2 - 119:12 (BAIS did not want an exclusive with Microsoft); Bozich Dep., 1/13/99, at 121:22 - 122:7 (US West did not want to be prohibited from offering customers a choice); Rys Dep., 1/13/99, at 175:2 - 176:14 (Ameritech wanted to offer choice).

(3) Microsoft witnesses' testimony that its ISP and OLS agreements did not have an exclusionary impact is unreliable

252. The AdKnowledge data and Microsoft's own documents, among other evidence, demonstrate that Microsoft's agreements had a substantial exclusionary impact. By contrast, the figures cited by Cameron Myhrvold in an attempt to show a purported lack of anticompetitive effect (Myhrvold Dir. ¶¶ 65-80; MPF ¶¶710, 750) are incomplete and unreliable.

- i. Myhrvold was unable to give an estimate -- other than to "hazard a guess" -- of the percentage of shipments by referral server ISPs accounted for by Internet Explorer in 1997. Myhrvold, 2/10/99am, at 41:4-19. While conceding that it was difficult for Microsoft to gather distribution data from the ISPs (Myhrvold, 2/10/99pm, at 47:4-25), Myhrvold nonetheless relied upon the sparse data available in arguing that Microsoft's contracts did not inhibit the distribution of other browsers. Myhrvold Dir. ¶¶ 65 -78.
- ii. Myhrvold's figures are also flawed because they are based on ISP reporting forms that may undercount the distributions of Internet Explorer. As Mr. Myhrvold conceded, it is impossible to tell whether the reports counted all copies of Internet Explorer; he does not even know why the forms contain different reporting standards for Internet Explorer and Netscape Navigator. Myhrvold, 2/10/99am, at 60:9 - 62:6.

- iii. Nor do Mr. Myhrvold's figures take into account that the ISPs included as having shipped large numbers of Netscape Navigator immediately after entering into an arrangement with Microsoft might have been exhausting old inventory, Myhrvold Dir. ¶ 70 (citing large numbers of Netscape Navigator distributed by Concentric during the the first three quarters of 1997), even though Myhrvold concedes that the reported ISPs were exhausting inventories of Navigator. Myhrvold, 2/10/99am, at 54:13 - 55:4 (Microsoft did not expect companies to instantly meet the shipment percentages because "every company in the Internet referral server took some time to ramp up to Internet Explorer." Therefore Concentric was not alone in falling short of its shipment percentages while it was shifting over to Internet Explorer.).
- iv. Myhrvold also neglected to include, in the figures supposedly illustrating a lack of foreclosure, some of the most recent data that Microsoft has. Myhrvold, 2/10/99am, at 59:11 - 60:8. By contrast to the implication in Myhrvold's testimony (Myhrvold Dir. ¶¶ 70-71), Concentric's shipments of Internet Explorer are increasing precipitously; and, in March 1998, Concentric reported a net return (or a negative distribution) of non-Microsoft browsers. GX 1798.
- v. Nor did Myhrvold mention that the most recent forecast for Earthlink in Microsoft's possession predicted Internet Explorer shipments to be 80.6% of overall shipments from October 1997 - December 1997. Myhrvold Dir. ¶ 76 (not citing the most recent Earthlink browser shipment figures); GX 1789 (most recent Earthlink predictions of Internet Explorer shipments). He also failed to mention that the earlier figures on non-Microsoft browser shipments by Earthlink were a result of a special arrangement with Microsoft; an internal Microsoft e-mail giving background on Microsoft's referral server program states: "The Earthlink deal was special because we needed to get a big ISP to sign up for the IE Referral Server Program and Earthlink was the first to sign." GX 228, at MS98 0113059.
- vi. Another stark example of Microsoft's courthouse estimates differing from its own internal tracking documents can be found in the Netcom numbers: According to Microsoft's internal documents, Netcom's Internet Explorer shipments as of the FY 1998 Mid Year Review were 40%. GX 366. A contemporaneous Microsoft e-mail confirms that Netcom was shipping Internet Explorer to approximately 40% of its customers. GX 228. By contrast, Microsoft's filings with the Court show, Netcom's Internet Explorer shipments through January of 1997 as only 1.2%. Myhrvold Dir. ¶ 66.

253. Dean Schmalensee also opined that Microsoft's agreements did not have a substantial exclusionary effect. His analysis is incorrect because, among other factors, it is based on flawed data

from Market Decisions Corporation (“MDC”).

- i. See infra Part VII.A.5.b.; ¶¶ 374 - 379.2.2.

253A. Microsoft's argument that many of the ISPs included in Microsoft's referral server program were also included in Netscape's referral server (MPF ¶ 710) is of no consequence. Microsoft's contracts did not prevent Netscape from promoting ISPs; rather, they prevented ISPs from promoting Netscape. Even the ISPs in Netscape's referral server had exclusionary agreements with Microsoft that limited their ability to promote and distribute rival browsers, including Netscape.

- i. See supra Part V.D.2.b.; ¶¶ 217-18 (summarizing restrictive terms of Microsoft's referral server agreements).

(4) Microsoft's failure to enforce certain restrictions, and its partial waiver of them on the eve of this litigation, do not eliminate the agreements' anticompetitive effects

254. Microsoft witnesses also argued that its restrictions did not have a significant impact because Microsoft did not actively monitor compliance or enforce their terms. Myhrvold ¶ 36 (arguing that Microsoft “never attempted to enforce” the IEAK contractual provision requiring ISPs to make Internet Explorer their “preferred browser”); Myhrvold, 2/10/99pm, at 42:19-22 (“We don't place any restrictions on that. We don't say this is the behavior you must do to meet that—to meet that condition.”). This argument is wrong.

254.1. First, ISPs were contractually bound to honor, and in large measure did in fact honor, Microsoft's restrictions. Although Mr. Myhrvold on the stand sought to portray Microsoft's contractual restrictions as “requests,” he conceded under questioning by the Court that Microsoft

“conditioned” its licensing agreements on these exclusionary terms and that ISPs are thus “arguably in violation of their license” if they do not make Internet Explorer their preferred browser.

- i. Myhrvold conceded that the licenses are conditioned on Internet Explorer being the preferred browser. “It does require it makes it their preferred browser.” Myhrvold, 2/10/99pm, at 42:16-17; Myhrvold, 2/10/99pm, at 41:15 - 43:7.

254.2. Second, Microsoft did, in fact, enforce its restrictions. Microsoft actively monitored compliance with the shipment restrictions limiting the distribution of non-Microsoft browsers.

- i. Microsoft monitored ISPs’ compliance with its shipment restrictions by requesting that ISPs report the number of non-Microsoft browsers distributed. GX 368 (Microsoft e-mail requesting competitive browser shipment estimates from certain ISP accounts, including Netcom, Concentric, Earthlink, and Mindspring).
- ii. Microsoft took notice when ISPs failed to meet certain requirements and took steps to ensure compliance. Myhrvold, 2/10/99am, at 55:5-14.
- iii. Although it is not clear whether Microsoft ever removed an ISP from the referral server for breaching its obligations (GX 228, at MS98 0113062 (suggesting that Netcom might have been temporarily removed from the Internet Explorer 4 referral server, which was “negatively affect[ing] our business”)), it is clear that Microsoft at least considered removing ISPs. A February 1998 Microsoft presentation proposed terminating Earthlink and Brigadoon from the Referral Server for “noncompliance” of their contracts. GX 429, at MS98 0102462. (sealed)

254.3. Third, Microsoft stringently enforced the most important restrictions, those it imposed on Online Services, in particular AOL.

- i. David Colburn testified that Microsoft carefully monitored any references to Netscape Navigator on AOL’s service. Colburn Dir. ¶ 30. For instance, Brad Chase, the Microsoft executive in charge of its relationship with AOL, complained when it appeared that AOL took steps to align with Netscape, thus threatening to impair what Chase viewed as the “virtual exclusivity” terms to which AOL had agreed. Colburn, 10/29/98pm, at 58:9 - 59:12.

- ii. In one e-mail, Colburn assured Chase that AOL was not selling advertising on the AOL service to Netscape and had, in fact, “stamped the NS issue into the ground”. GX 186.

255. Microsoft witnesses also made much of the fact that, immediately before this case was filed, Microsoft waived some of the restrictions in its IRS agreements. (GX 374; Myhrvold Dir. ¶¶ 91-92). But Microsoft’s partial waiver is of very limited significance.

255.1. First, Microsoft did not waive any restrictions in its more competitively significant agreements with OLSs and specifically declined AOL’s request that it waive the restrictions Microsoft placed on AOL’s dealings with other browsers. Microsoft’s exclusionary restrictions, therefore, remain in effect with the largest providers of Internet access, including AOL.

- i. Mr. Chase testified that Microsoft did not waive the preference clauses for certain OLS’s. Chase, 2/16/99pm, at 21:4-7.
- ii. GX 226 (AOL letter to Microsoft stating that Microsoft’s refusal to include OLSs in the waiver excludes “a substantial percentage of the US ISP business.”).
- iii. Professor Fisher testified that “restrictions were not waived for ISPs who were OLSs.” Fisher Dir. ¶ 188
- iv. David Colburn testified that Microsoft has “demanded that AOL continue with” the “exclusivity provisions or lose the right of Compuserve to be included in the Online Services Folder and the ICW, and for AOL to continue to be listed in the referral server.” Colburn Dir. ¶ 47.

255.2. Second, even with respect to ISPs, Microsoft did not waive all of the restrictions.

- i. Microsoft still prohibits ISPs that appear in the Internet Connection Wizard from offering or promoting Netscape or other browsers as their “default” browser. Fisher Dir. ¶ 187.

- ii. In addition, since a number of mostly small ISPs choose to distribute only one browser in order to reduce support costs, the “requirement of ‘parity’ for Internet Explorer in order to secure access to the ICW may amount to a de facto requirement that the ISP exclusively support Internet Explorer.” Warren-Boulton Dir. ¶ 109.

255.3. Third, and most important, Microsoft relaxed the restrictions only after the damage was done. As explained, Microsoft’s restrictions, including the restrictions it recently relaxed, substantially contributed to Internet Explorer’s increasing share and Netscape Navigator’s decline.

- i. See supra Part VII.A.3.; ¶¶ 369-370.4.2.
- ii. Professor Fisher testified: “Whatever the extent of Microsoft’s waiver, it did not undo the harm to competition that had already occurred.” Fisher Dir. ¶ 190.
- iii. Warren-Boulton testified that Microsoft cannot erase the “significant anticompetitive effects” of the restrictions “simply by removing” them. Warren-Boulton Dir. ¶ 109; see also Warren-Boulton, 11/30/98pm, at 60:7-23; 15:16 - 17:17 (explaining that, by the time Microsoft lifted its restrictions, the game was “pretty well over.”)
- iv. Microsoft’s own documents reflect its belief that around the time it waived its restrictions it had “won” the browser war and vitiated the threat Netscape posed to its operating system monopoly. See infra Part VII.A.4.; ¶ 371; Part VII.B.3.c.; ¶ 388.2.

(5) Microsoft’s agreements were exclusionary and anticompetitive notwithstanding the small number of subscribers ISPs and OLSs garnered from the referral server

256. Microsoft witnesses also suggested that its agreements could not have been anticompetitive because OLSs and ISPs obtained only a small percentage of their subscribers through the Online Services Folder and Internet Connection Wizard (Myhrvold Dir. ¶¶ 82-85, 124; Schmalensee Dir. ¶¶ 424-425). But this assertion ignores that Microsoft’s agreement restricted ISPs’

and OLS's distribution and promotion of rival browsers in all channels and to all customers, not merely to customers who contacted the access provider through the OLS Folder or ICW.

- i. See supra Part V.D.2.d.; ¶ 223.

5. Microsoft's justifications for its agreements are pretextual

257. Microsoft witnesses advanced a number of justifications for its efforts to obtain preferential distribution of its browser through ISPs and OLSs. Their arguments, however, can explain neither Microsoft's expensive effort to gain distribution of its browser through access providers nor the exclusionary restrictions that it paid access providers to accept.

257.1. First, Microsoft contends that its restrictive terms are justified because Microsoft has an interest in preventing firms that take its valuable assistance from turning around and promoting rivals. Chase Dir. ¶ 98; MPF ¶¶ 823, 825. As Chase explained, "given the commitment we were making to AOL, we wanted AOL to commit to using IE." Chase Dir. ¶ 75. This contention is misconceived.

257.1.1. Microsoft did not need the exclusionary provisions in order to be fully compensated for the consideration it gave to the ISPs and OLSs. It could have asked for money or other compensation, rather than exclusion, in exchange for the browser, technical assistance, desktop placement, and other value Microsoft provided.

- i. Dr. Warren-Boulton testified that "there is no reason why Microsoft had to take its compensation in the form of exclusionary agreements rather than a simple payment. That ISPs commonly agree to pay for customer referrals and promotion of their services demonstrates that selling desktop real estate does not involve prohibitive transaction costs." Warren-Boulton Dir. ¶ 183.

- ii. Professor Fisher testified that “rather than trading desktop space for financial remuneration, Microsoft placed requirements on ISPs that hindered their ability to promote or distribute Netscape Navigator.” Fisher Dir. ¶ 192.
- iii. Bill Gates recognized that Microsoft had the option to “monetize the box, and sell the real estate to the highest bidder”, but instead chose to use placement on the Windows desktop “for the browser battle.” GX 1372, at 5.
- iv. OEMs charged fees for promoting access providers’ services (Colburn Dir. ¶ 18), and there is no reason why Microsoft could not have done so as well; see also GX 621 (Microsoft’s willingness to bundle AOL’s software with Windows made a browser deal with Microsoft potentially more profitable than a Netscape deal because AOL would save the bounties it would otherwise pay OEMs).

257.1.2. The breadth of Microsoft’s restrictions belies its contention that it merely wanted to ensure that ISPs did not promote other browsers to customers that it gained from Microsoft.

- i. Microsoft’s contract with AOL (to take an example applicable to all of Microsoft’s IRS and OLS agreements) prohibits AOL from distributing Netscape upon customer request, if doing so exceeds the limitations contained in the shipment restrictions, even if that customer never had any contact with the Online Services Folder or benefitted from any of the technical assistance Microsoft provided AOL. See supra Part V.D.2.a.; ¶ 216. AOL obtains the majority of its subscribers from channels other than Microsoft. DX 2098, at D-2.
- ii. Dr. Warren-Boulton testified that “Microsoft’s restrictions on the ability of ISPs, OLSs, and ICPs to promote and distribute competing Internet browsers are unrelated to any efficiency purpose.” Warren-Boulton Dir. ¶ 182.

257.2. Second, Microsoft witnesses point out that the Internet Connection Wizard, Online Services Folder, and associated features are intended to make it easy for users to hook-up to the

Internet (Myhrvold Dir. ¶ 43; Schmalensee Dir. ¶¶ 441-442); see also MPF ¶ 718. But this cannot justify Microsoft's exclusionary restrictions because restricting the distribution or promotion of other browsers is unnecessary to achieve this benefit. To the contrary, the very video demonstration Mr. Myhrvold sponsored shows that OEMs can give users a "seamless" experience connecting to the Internet by adding the Netscape referral server to Windows.

- i. Cameron Myhrvold testified that OEMs can add the Netscape referral server to Windows, explaining: "in this example, if you're talking about offering a seamless experience to the user, I think it may. If they click on that icon, they get the referral server." Myhrvold, 2/9/99pm, at 35:9 - 37:2.

257.3. Third, Microsoft argues that "Microsoft's agreements with the ten ISPs in the Windows 95 Referral Server were the type of cross marketing agreements that are routine in all industries, particularly in connection with the Internet" (Myhrvold Dir. ¶ 88; see also Chase Dir. ¶ 97 (same for OLSs)); **MPF ¶ 724** But Microsoft's agreements are not ordinary cross marketing arrangements.

257.3.1. The terms of Microsoft's agreements are inconsistent with Microsoft's "cross marketing" characterization. As explained, Microsoft's "shipment restrictions" prohibit access providers from supplying non-Microsoft browsers to customers, even when customers specifically request other browsers and even if the ISP obtained the customer for reasons wholly unrelated to Microsoft's promotion of it.

- i. See supra Part V.D.2.; ¶¶ 215.3-4, 216, 217.3-5.

257.3.2. Contrary to the testimony of Microsoft witnesses, the terms Microsoft extracted are not "routine." Netscape's agreements with the RBOC's Internet access providers, for

instance, are substantially different; **in fact, they are dramatically less restrictive than Microsoft's exclusionary ISP agreements.**

257.3.2.1. Netscape's agreements are significantly less restrictive than Microsoft's.

- i. The RBOCs agreed to make Netscape Navigator their "default" browser and to certain promotional restrictions. But, by contrast to the terms Microsoft extracted, the RBOCs did not agree to restrictions on their ability to distribute other browsers, such as Internet Explorer, in response to customer requests or otherwise. Beran Dep., 1/13/99, at 119:14 - 120:15 (testifying that, under its agreement with Netscape, Bell Atlantic was "free to offer other browsers").
- ii. James Barksdale testified that Netscape's RBOC contracts "are not exclusive There is nothing in the contracts that prohibits the RBOCs from distributing another browser to their customers--in any numbers." Barksdale Dir. ¶¶ 131-132.
- iii. Indeed, RBOC representatives testified that they preferred dealing with Netscape because the restrictions insisted upon by Microsoft were more onerous and "thwarted" their "objective of providing browser choice." Beran Dep., 1/13/99, at 117:10 - 119:12.

257.3.2.2. Even the terms in the Netscape agreements that call for Navigator to be the default browser were in direct response to Microsoft's restrictions on the largest access providers. In other words, they were part of Netscape's effort to open up a channel of distribution which Microsoft had closed.

- i. The terms securing preferences for Netscape were negotiated only after Microsoft diminished Netscape's opportunities by entering into its exclusionary agreements with the most significant access providers. Indeed, Netscape's contracts with the RBOCs required default status for Navigator only "so long as

AT&T and MCI . . . are both restricted by agreement from providing Navigator to their customers.” GX 1151, at AM 00076 (Amendment to the Network Service Provider Distribution Agreement, section 15); GX 1152, at RAA 0074 (Amendment to the OEM License Agreement between Netscape and Bell Atlantic, section 15).

- ii. **Beran testified that Netscape would only be the “default” browser for so long as Netscape was unable to enter into agreements with AT&T and MCI for the provision of Navigator. Beran Dep., at 51:12 - 52:5 (DX 2557A)(sealed)**

257.3.2.3. **While Microsoft attempts to characterize the RBOCs as “large” ISPs, (MPF ¶ 712; see also ¶ 751), Netscape’s agreements with the RBOCs account for only a small percentage of Internet access in the United States.**

- i. Myhrvold conceded that the RBOCs combined have a subscriber base between 1 and 2 million, less than 10% of AOL’s subscribers. Myhrvold, 2/10/99pm, at 79:11 - 80:5.
- ii. Barksdale testified that “the RBOCs account for less than 5% of the total ISP marketplace.” Barksdale Dir. ¶ 132.

257.3.2.4. Microsoft’s agreements are not typical cross marketing agreements for a more fundamental reason. In typical cross marketing arrangements, the product being marketed is a profitable product. But Microsoft’s effort to purchase browser market share can be explained only as a strategy designed to weaken Netscape and protect Microsoft’s operating system monopoly.

- i. See infra Part V.G.2; ¶¶ 299.4.1.

257.3.2.5. Microsoft notes Netscape had a referral server and the ISPs in Netscape’s referral server featured only Navigator, and implies that Netscape's

ISP agreements required exclusivity. MPF ¶ 714. In fact, however, there is no evidence that Netscape prevented the ISPs participating in its referral server from shipping or promoting Internet Explorer.

- i. To the contrary, some ISPs refused to enter into contracts with Microsoft, and chose to participate in Netscape's referral server, precisely because Netscape allowed them to offer browser choice. Beran of Bell Atlantic,

Beran Dep.,
8/5/98 at 90:3-24 (DX 2557A)(sealed). Netscape, on the
other hand, did not require "minimum shipment levels,"

Beran Dep., 8/5/98 at 57:15 - 60:17 (DX
2557A)(sealed).

257.4. Fourth, Microsoft argues that it entered into agreements with ISPs to appear in the referral server in order "[t]o provide Windows users with a choice of some leading regional and national ISPs." MPF ¶ 721. But Microsoft was not merely attempting to provide users choices; it was actively restricting consumer choice among browsers.

- i. See, e.g., supra ¶¶ 217, 218, 221 230.
- ii. Myhrvold, 2/10/99am, at 62:7 - 64:20.