

In 1998, all major OEMs agreed to this restriction. Naturally, it is hard to sell a pirated copy of Windows to a consumer who has already received a legal copy included in the price of his new PC system. Thus, Microsoft is able to effectively contain, if not extinguish, the illegal secondary market for its operating-system products. So even though Microsoft is more concerned about piracy than it is about other firms' operating system products, the company's pricing is not substantially constrained by the need to reduce the incentives for consumers to acquire their copies of Windows illegally.

#### **F. Price Restraint Posed by Long-Term Threats**

59. The software industry in general is characterized by dynamic, vigorous competition. In many cases, one of the early entrants into a new software category quickly captures a lion's share of the sales, while other products in the category are either driven out altogether or relegated to niche positions. What eventually displaces the leader is often not competition from another product within the same software category, but rather a technological advance that renders the boundaries defining the category obsolete. These events, in which categories are redefined and leaders are superseded in the process, are spoken of as "inflection points."

60. The exponential growth of the Internet represents an inflection point born of complementary technological advances in the computer and telecommunications industries. The rise of the Internet in turn has fueled the growth of server-based computing, middleware, and open-source software development. Working together, these nascent paradigms could oust the PC operating system from its position as the primary platform for applications development and the main interface between users and their computers. Microsoft recognizes that new paradigms

could arise to depreciate the value of selling PC operating systems; however, the fact that these new paradigms already exist in embryonic or primitive form does not prevent Microsoft from enjoying monopoly power today. For while consumers might one day turn to network computers, or Linux, or a combination of middleware and some other operating system, as an alternative to Windows, the fact remains that they are not doing so today. Nor are consumers likely to do so in appreciable numbers any time in the next few years. Unless and until that day arrives, no significant percentage of consumers will be able to abandon Windows without incurring substantial costs. Microsoft can therefore set the price of Windows substantially higher than that which would be charged in a competitive market — or impose other burdens on consumers — without losing so much business as to make the action unprofitable. If Microsoft exerted its power solely to raise price, the day when users could turn away from Windows without incurring substantial costs would still be several years distant. Moreover, Microsoft could keep its prices high for a significant period of time and still lower them in time to meet the threat of a new paradigm. Alternatively, Microsoft could delay the arrival of a new paradigm on the scene by expending surplus monopoly power in ways other than the maintenance of high prices.

**G. Significance of Microsoft's Innovation**

61. The fact that Microsoft invests heavily in research and development does not evidence a lack of monopoly power. Indeed, Microsoft has incentives to innovate aggressively despite its monopoly power. First, if there are innovations that will make Intel-compatible PC systems attractive to more consumers, and those consumers less sensitive to the price of Windows, the innovations will translate into increased profits for Microsoft. Second, although