

**C. Microsoft imposed a variety of other anticompetitive restraints on the OEM channel in order to impede rivals such as Netscape**

**1. Microsoft imposed exclusionary restrictions on OEMs' ability to modify the Windows desktop and start-up sequence**

175. In addition to its tying arrangement, Microsoft forced OEMs to agree to restrictions on their ability to modify the Windows desktop and start-up sequence. As with its tying arrangement, Microsoft's OEM desktop and start-up restrictions raised rivals costs, harmed consumers, and cannot be explained except as part of Microsoft's effort to blunt the threat to its operating system monopoly posed by non-Microsoft browsers.

**a. Microsoft imposed the "Windows Experience" restrictions in response to, and in order to stop, OEMs' featuring Netscape Navigator more prominently than Internet Explorer.**

176. When Microsoft first released Windows 95, OEMs customized the Windows 95 desktop and start-up sequence in various ways designed to meet consumer demand; and they did so with Microsoft's tacit or express consent.

176.1. OEMs operate in a competitive environment; to thrive, OEMs must supply what their customers demand, differentiate their products, minimize their support costs, and offer PCs that are easy to use.

- i. Professor Fisher explained: "OEM's are, in some sense, the representatives of the consumer for certain purposes. They are in competition with each other. They gain if they deliver what end users actually want. They wouldn't care about the restrictions on them if they didn't think that it mattered in their dealings with consumers." Fisher, 6/2/99am, at 22:1-6.
- ii. Dr. Warren-Boulton testified: "As Microsoft has acknowledged, OEMs are in the business of satisfying their customers. They are exceedingly unlikely to market a product that does not meet consumer demand." Warren-Boulton Dir. ¶ 160.

- iii. Garry Norris testified that IBM sought to “differentiate PC’s that were shipping from IBM versus those shipping from competitors” in order to ensure that new users, “a large percentage” of whom “are novices,” understand “how to navigate . . . their PC.” Norris, 6/7/99pm, at 42:14-25. “The reason” IBM “invested the millions of dollars . . . was, in fact, to differentiate the IBM Aptiva ‘out of box’ experience and end-user experience with that of our competitors.” Norris, 6/7/99pm, at 56:10-18. Norris further testified that, if IBM “designed a confusing or a poor” product, IBM would be negatively impacted “in the market.” Norris, 6/7/99pm, at 69:2-14.
- iv. A Hewlett-Packard executive told Microsoft: “PC’s can be frightening and quirky pieces of technology into which” consumers “invest a large sum of their money. It is vitally important that PC suppliers dramatically improve the consumer buying experience, out of box experience as well as the longer term product usability and reliability.” GX 309.
- v. Compaq’s Celeste Dunn testified that the PC consumer segment is “a really tough segment of the market, because there is a lot of price point pressure.” Dunn Dep., 10/23/98, at 26:19-25 (DX 2566).

176.2. With the release of Windows 95, OEMs sought to achieve these objectives

-- and to meet consumer demand -- by, among other things, customizing the Windows start-up sequence to include tutorials and other features that run in the “boot-up” or “start-up” process before the user is presented with the Windows desktop.

- i. IBM. IBM developed an “out-of-box” (Norris, 6/7/99pm, at 46:18 - 48:25) experience that included the “IBM Welcome Center” in the start-up sequence that instructed users on basic features of their PCs, such as “how to use a mouse, how to run Windows 95” and “what an icon is.” Norris, 6/7/99pm, at 42:9 - 43:9. IBM placed the Welcome Center in the start-up sequence because usability studies showed that “a large percentage of new users are novices” and IBM “wanted to ensure that they understood how to navigate, so to speak, through their PC.” Norris, 6/7/99pm, at 42:14 - 43:3. By making new users “more self-sufficient” before they reached the Windows desktop for the first time, the Welcome Center helped IBM reduce support costs. Norris 6/7/99pm, at 59:1-15; GX 2191 (the Aptiva “Windows Guide” heightened “the consumer’s experience with new features of their computer system”); GX 2187 (“If anything our welcome

program helps acquaint the user with the machine, mouse, Windows, and gently delivers them to the Windows desktop.”).

- ii. Hewlett-Packard. Hewlett-Packard also developed an “out-of-box experience” that included placing several screens in the start-up process. Romano Dep., (played 12/16/98pm), at 38:7-14.
- iii. Dell. Dell PCs automatically completed the set-up of all software during the boot-up sequence. Kanicki Dep., (played 12/16/98pm), at 65:3-18.
- iv. Compaq. Microsoft allowed Compaq to “add Compaq welcome screens and non-MS advertisements.” GX 292.

176.3. Although Microsoft’s original Windows 95 licenses prohibited certain OEM modifications,

- i. Microsoft’s Windows 95 licenses typically provided:

- ii. But a Microsoft letter to Hewlett-Packard acknowledged that HP permitted users a choice of an alternative desktop “shell,” in addition to the graphical user interface provided by the ordinary Windows desktop. GX 294.

177. By contrast, when OEMs customized their PCs in ways that threatened Microsoft’s objective of gaining browser usage share, Microsoft moved quickly both to enforce and to augment its restrictions.

177.1. Microsoft construed its licenses to prohibit OEMs from removing the Internet Explorer icon from the desktop.

- i. A Microsoft document reports that, in July 1995: “Some” OEMs “want to remove the” Internet Explorer “icon from the desktop -- our response should be that this is not allowed.” GX 296.
- ii. Microsoft forced Compaq to restore the Internet Explorer icon to the Windows desktop. See *infra* Part V.C.2.a(1); ¶¶ 200.2-5.
- iii. Kempin conceded that Microsoft denied OEM requests to remove the Internet Explorer icon. Kempin, 2/25/99pm, at 64:6-12 (Gateway asked if it could remove the Internet Explorer icon, but Microsoft denied the request. “We basically said, ‘we thought we had an agreement that’ Gateway ‘cannot change our code and our work.’”).

177.2. Microsoft also became very concerned when OEMs found other ways to highlight non-Microsoft browsers and, in response, set out to impose new, more rigid restrictions.

- i. On January 6, 1996, Bill Gates wrote Joachim Kempin, head of Microsoft OEM sales, that: “Apparently a lot of OEMs are bundling non-Microsoft browsers and coming up with offerings together with Internet Service providers that get displayed on their machines in a FAR more prominent way than MSN or our Internet Browser”; reminding Kempin that “[w]inning Internet browser share is a very very important goal for us,” Gates also requested “an analysis of the top OEMs of what they are doing with browsers.” GX 295.
- ii. The resulting January 16, 1996, analysis showed that “other internet solutions are not only on every hard disk, but are invariably positioned on the desktop more strongly by OEMs than any MS offerings” and that a number of OEMs had configured their PCs to boot automatically into desktop shells that featured Netscape Navigator but not Internet Explorer. GX 297 (“Compaq Presario 9546. Tabworks [Compaq’s alternative shell that was presented to users automatically] is on the system, but we started up in the Win95 shell. Perhaps someone played with this box at the store before us getting it. MSN is not on the desktop; AOL is on the desktop. IE is on the desktop as well. If you start up Tabworks, AOL, CIS, INN, Netscape, Prodigy, CNN (AOL’s internet access service) are all top level tabs. MSN and IE are not, nor are they in the Tabworks index.”).
- iii. Less than a week later, Kempin wrote in his semi-annual report on Microsoft’s OEM Sales that a top goal for the upcoming months was to

“Make OEMs Support our Internet Efforts” and that one thing Microsoft “Missed in 1st Half of FY 1996” was “Control over start-up screens, MSN and IE placement.” GX 401, at MS6 600019, -23.

- iv. Kempin conceded at trial that he intended to solve the problem of Internet Explorer placement through control over start-up screens. Kempin, 2/25/99am, at 43:4-15.

177.3. Accordingly, throughout 1996 and into 1997, Microsoft forced OEMs to agree, either as amendments to existing Windows licenses or in new Windows licenses, to a series of restrictions on their ability to customize the Windows desktop and boot-up sequence that Microsoft called the “Windows Experience.”

177.3.1. Among other things, these restrictions:<sup>1</sup>

177.3.1.1. Prohibited OEMs from removing any icons, folders, or start-menu entries that Microsoft places on the Windows desktop, including the Internet Explorer icon;

177.3.1.2. Prohibited OEMs from modifying the Windows 95 start-up sequence;

177.3.1.3. Prohibited OEMs from configuring programs, including alternative OEM shells -- alternative desktop screens and user interfaces, in lieu of the Windows desktop -- as well as programs to complete the installation of software, to launch automatically at the completion of the Windows start-up sequence; and

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<sup>1</sup>GX 1129, at MSV 0005245 (Packard Bell); GX 647, at MSV 0002127 (Toshiba) (sealed); GX 1183, at MS98 0009095 (Hewlett-Packard) (sealed); GX 1374, at MS98 0009538 (Hitachi) (sealed); GX 458, at MS98 0009146 (Gateway) (sealed); GX 1375 (Sony) (sealed); GX 1060, at MS98 0009311 (AST) (sealed); GX 1373, at MS98 0009399 (Micron) (sealed).

177.3.1.4. Prohibited OEMs from adding icons or folders to the Windows 95 desktop that were not similar in size and shape to Microsoft supplied icons.

177.3.2. OEMs acquiesced in these restrictions because they had no choice.

- i. Hewlett-Packard's John Romano wrote Microsoft, in response to the imposition of the Windows Experience, that: "If we had a choice of another supplier, based on your actions in this area, I assure you [sic] would not be our supplier of choice." GX 309.
- ii. Dean Schmalensee conceded that OEMs lack any practical alternative to Windows and thus must accept Microsoft's terms. Schmalensee, 1/20/99am, at 33:3 - 34:9.

177.4. Microsoft broadened its OEM restrictions when it introduced Internet Explorer 4.0, which included a feature known as the "Active Desktop," in order to prohibit OEMs from using the Active Desktop to feature third-party brands on the desktop.

- i. Microsoft introduced with Internet Explorer 4.0 a feature known as the "Active Desktop." Schmalensee Dir. ¶¶ 465-467. This feature, which overlays the standard Windows desktop, permits OEMs to place on the desktop items that are both more interactive and significantly larger than the icons placed on the standard Windows desktop. Kempin Dir. ¶¶ 49-50; DX 2163 (demonstrating the Active Desktop).
- ii. Although the Active Desktop enables OEMs "to promote prominently" particular products or services (Kempin Dir. ¶ 49)

GX 1201, at MS98 0102862

(Appendix A, OPK Requirements and Restrictions has identical language as GX 458). Thus, while an OEM could place a large item in the center of the desktop that reads, "click here to learn more about your PC," DX 2163 (Kempin's videotape),

**b. Microsoft’s restrictions significantly increased the costs to OEMs and end users of preinstalling or using non-Microsoft browsers**

**(1) Microsoft intended its restrictions to facilitate winning the browser war**

178. The origins of the Windows Experience (see supra ¶¶ 176-177) demonstrate that Microsoft’s purpose in enforcing and augmenting its OEM restrictions was to gain browser usage share and thereby thwart the threat to its monopoly presented by non-Microsoft browsers; other evidence confirms Microsoft’s exclusionary purpose.

178.1. Microsoft’s restrictions imposed significant costs and inefficiencies on OEMs and, ultimately, on OEMs’ end-user customers.

- i. IBM. Although Microsoft representatives told IBM “that they thought” IBM’s “Welcome Center enhanced the end user’s experience,” Microsoft forced IBM to scrap its out-of-box experience. Norris, 6/7/99pm, at 61:14 - 63:25. IBM expected support costs to rise as a result of the inability to offer its tutorial screens in the start-up sequence. Norris, 6/7/99pm, at 49:20 - 50:15 (testifying that IBM anticipated support “costs going up” as a result of Microsoft’s restrictions); Norris, 6/7/99pm, at 70:16 - 71:17 (explaining that complying with Microsoft’s restrictions would cause IBM to “lose” its “investments, restart, and redevelop” its “Access Aptiva” feature). Microsoft’s restrictions also precluded IBM from implementing other features useful for consumers, such as “information screens assisting customers with installations such as warning to avoid power cycling during setup.” GX 2191. Although IBM told Microsoft that its restrictions made “the system . . . harder to use” and would confuse users, Norris, 6/7/99pm, at 55:19-25; GX 2141 (July 30, 1996 letter from IBM to Kempin, stating “restriction will negate the system tutorial features that are currently booting and will make the system harder to use, particularly for computer novices.”); GX 2193 (notes of August 13, 1996, IBM/Microsoft; IBM tells Microsoft that restrictions a “major blow to brand and value”), Microsoft refused to lift all but trivial restrictions. Norris, 6/7/99pm, at 65:7 - 66:20.
- ii. Hewlett-Packard. Hewlett-Packard reported in a March 1997 letter regarding Microsoft’s restrictions that “Microsoft’s mandated removal of

all OEM boot-sequences and auto-start programs for OEM licensed systems has resulted in significant and costly problems for the HP Pavilion line of retail PCs.” GX 309. As “a direct result” of Microsoft’s restrictions, HP’s “support calls went up by approximately ten percent.” Romano Dep., (played 12/16/98pm), at 41:20 - 42:6. The letter continued:

“From the consumer perspective, we are hurting our industry and our customers. PC’s can be frightening and quirky pieces of technology into which they invest a large sum of their money. It is vitally important that the PC suppliers dramatically improve the consumer buying experience, out of box experience as well as the longer term product usability and reliability. The channel feedback as well as our own data shows that we are going the wrong direction. This causes consumer dissatisfaction in complex telephone support process, needless in-home repair visits and ultimately in product returns. Many times the cause is user misunderstanding of a product that presents too much complexity to the common user.”

“We strongly protested the changes last fall and were flatly refused any leeway. We also, as of October of 1996, began to request what we would be able to do in the future. We were continuously put off as to what the future policy would be. But we were led to believe that we would be granted some options.”

“Our Customers hold HP accountable for their dissatisfaction with our products. We bear for the cost of returns of our products. We are responsible for the cost of technical support of our customers, including the 33% of calls we get related to the lack of quality or confusion generated by your product. And finally we are responsible for our success or failure in the retail PC market.” GX 309.

iii. Compaq.

GX 120 (sealed); see also Dunn Dep., 10/23/98, at 130:15 - 134:2 (DX 2566) (sealed)

GX 756, at COM-8-000048 (sealed). Compaq more recently expressed concern that the “Windows desktop experience” means “(1) loss of revenue to Compaq for ISP subscriptions, (2) loss of revenue due to inability to send customers to our portal, (3) customer dissatisfaction due to confusion over the best way to



get onto the Internet, and (4) customer dissatisfaction due to non-functioning ISPs.” GX 326 (9/98). See also infra Part V.C.2.1(a); ¶ 200.5 (Compaq voluntarily adhered to the restrictions).

- iv. Dell. Dell determined that compliance with the Windows Experience would increase technical support costs, “confuse and disappoint repeat customers,” and result in the “perception of Dell will be negatively effected.” GX 307.
- v. Gateway. Gateway concluded that Microsoft’s restrictions “jeopardized” its “direct relationships with” its “customers” and “limits choice for the majority of end users.” GX 302. Gateway also wrote Microsoft that it needed “to be able to remove icons if the customer does not choose those options” in order “to remove as much clutter from the screen as possible.” GX 319. The document summarized: “Generally, Gateway wants to have flexibility on anything associated with the Internet. We want MS to provide us with the technology, not make decisions and choices for us, or our customers.” GXs 319, 320 (same).

178.2. The costs imposed on OEMs and consumers by Microsoft’s restrictions reduced the value of Windows and impaired Microsoft’s goodwill; Microsoft would not rationally have inflicted these costs on OEMs and itself unless it expected a corresponding gain through excluding browser rivals.

- i. Warren-Boulton Dir. ¶¶ 189-94.

178.3. Microsoft selectively enforced its Windows Experience restrictions, further evidencing the anticompetitive purpose behind these restrictions.

- i. Kempin admitted that there is “no general rule” concerning when Microsoft enforces its restrictions; it examines each situation “in a pragmatic way.” Kempin, 2/25/99pm, at 93:24 - 94:3.
- ii. Microsoft granted certain requests for exceptions to its restrictions but has generally declined to grant exceptions that would undermine its objective of making it difficult for OEMs to feature browser rivals. See infra ¶¶ 186-187.

- iii. Kempin explained the exclusionary purpose of the selective enforcement in a September 17, 1996, memorandum to Bill Gates, in which Kempin, noting that OEMs had acquiesced in the Windows Experience “only reluctantly” and had pushed back in a number of areas, concluded that Microsoft should relax certain restrictions but “at the same time . . . ensure that no other advertising other than promoting the OEMs name brand can be done during” the “‘extended’ boot process.” GX 304. To allow OEMs to fully control the boot-up sequence, Kempin wrote that it would undermine Microsoft’s “strategic objectives,” which included promoting Microsoft’s “platforms.” GX 304.
- iv. Reflecting Kempin’s description of how the Windows Experience furthered Microsoft’s “strategic objectives,” Microsoft planned to move the Internet Connection Wizard to the Windows 98 start-up sequence because doing so “increases the likelihood that an end user gets the option to sign up for solutions that promote IE before they get into the desktop or any customized shell that features other browser solutions.” GX 176A.

178.4. Microsoft viewed alternative OEM shells as an important facet of the threat non-Microsoft browsers posed to its operating system monopoly, not only because shells could offer other browsers favorable promotion, but also because alternative OEM shells could hasten the adoption of Netscape’s APIs; Microsoft thus had a particular anticompetitive reason to impose the restrictions.

- i. Brad Chase testified that Netscape was “‘also trying to control and define user interfaces, which is another important element of an operating system.’” Fisher Dir. ¶ 89 (quoting Chase Dep., 3/25/98, at 39:6-8).
- ii. Jim Allchin testified: “‘The stated goal of Netscape was to replace the user interface of Windows were you couldn’t see it and to create a new set of API’s that developers would write to. It’s exactly what we see Sun doing as well.’” Warren-Boulton, 12/1/98am, at 39:20-23 (quoting Allchin Dep., 3/19/98, at 119:21-25).
- iii. Professor Fisher testified: “‘The browser could also threaten the operating system monopoly by providing an alternative user interface that would reduce users’ reliance on the dominant operating system interface. By providing a popular alternative user interface, browsers could reduce consumers’ resistance to non-Windows operating systems and enable

businesses that utilize the alternative interface to use different operating systems without increasing their training and support costs. In turn, this would reduce Microsoft's power to exploit the value of its interface real estate by requiring other companies to promote Microsoft's products through exclusive agreements." Fisher Dir. ¶ 89.

**(2) Microsoft's restrictions significantly raised the costs of its browser rivals, thereby impairing their ability to compete and harming consumers**

179. Microsoft's restrictions, in particular its prohibition on removing the Internet Explorer icon (and other visible means of end-user access to Internet Explorer, such as its entry on the start menu), raised the costs to OEMs of preinstalling rival browsers on the PCs they sell.

179.1. Including icons for additional browsers on the Windows desktop increases clutter and customer confusion, which translates into increased support costs the OEMs must bear.

- i. Gateway. Gateway wanted to remove the Internet Explorer icon from both Windows 95 and Windows 98 because Gateway determined that removing the icon would reduce its support costs should a user choose a Gateway-supplied option to install Netscape's browser. Von Holle Dep., 1/13/99, at 304:17 - 305:12, 310:24 - 312:21. "General usability studies," a senior Gateway executive testified, "indicate that the less cluttered the desktop . . . the less confusing it is for the customer to use the product." Von Holle Dep., 1/13/99, at 305:9-12; see also GX 320 ("We want to remove as much clutter from the screen as possible."); GX 652, at ATR-30008 (sealed)

Kempin, 2/25/99pm, at 63:9 - 64:15 (acknowledging Gateway raised these concerns and that its request was denied).

- ii. Packard Bell. John Kies testified that Packard-Bell likely would not preinstall Netscape's browser if the Internet Explorer icon were not on the desktop, among other reasons, because "it might be confusing to end users as to why two of the same applications were included." Kies Dep., (played 12/16/98am), at 17:4-11. Indeed, Packard Bell's Mal Ransom testified that to load Netscape if Internet Explorer is on the desktop, Netscape would have to "bring" Packard Bell "a business proposition in the way of

financial remuneration.” Ransom Dep., (played 12/16/98pm), at 78:13 - 79:8.

- iii. Compaq. Compaq’s Steven Decker testified that Compaq stopped preinstalling Netscape because “with the inclusion of Internet Explorer from Microsoft, that category is already filled because of the inclusion of the product with the operating system, and then also to actually license the additional browser that would involve both time by Compaq to put that particular agreement in place” as well as having “another product that would take up real estate on our hard drive” as well as any “additional licensing fees.” Decker Dep., 2/18/99am, at 61:2 - 63:19.

179.2. These cost increases caused by Microsoft’s restrictions distort competition between Internet Explorer and other browsers and in some cases are significant enough to deter OEMs from preinstalling Netscape Navigator altogether.

- i. Microsoft emphasized to OEMs the increased costs of supporting and testing a second browser and Kempin testified that this argument was “sometimes successful” in “persuading OEMs’ that they don’t really need to distribute another browser.” Kempin, 2/25/99am, at 62:25 - 65:6 (quoting Kempin’s deposition). Kempin’s attempt to distance himself from this admission by asserting that “OEM’s at the end of the day ship what end users demand and a small amount of support costs will not make them basically change their plan,” Kempin, 2/25/99am, at 65:19 - 66:7, is contradicted by other evidence regarding OEM installation of browsers. See infra Part VII.A.2.b; ¶ 363.4 (OEM bundling of Netscape has decreased dramatically since Microsoft embarked on its predatory campaign).
- ii. Compaq, as explained, stopped preinstalling Netscape on its PCs when Microsoft forced Compaq to restore the Internet Explorer icon to the Windows 95 desktop. See supra ¶ 179.1; infra ¶ 203.

179.3. The contrary and shifting testimony of John Rose (2/18/99am, at 63:20 - 64:6, 67:1-24) -- that Compaq removed Netscape not, as Steve Decker testified, because the “category was filled,” but rather because of its obligations to AOL and/or concerns regarding

compatibility -- is inconsistent with his other testimony, is not supported by the documents on which it purports to be based, and is not credible.

- i. Rose had no first hand knowledge concerning why Compaq removed Netscape (Rose, 2/18/99am, at 67:1-24) and did not even know until his cross-examination that Compaq ceased preinstalling Netscape on consumer lines in 1996. Rose, 2/18/99am, at 62:14-17; Rose, 2/19/99am, at 52:2-7.
- ii. Rose's testimony that Compaq generally does not load two applications in a similar software category on its personal computers because doing so "puts a greater cost burden on Compaq; adds more complexity; causes confusion to the customers, particularly consumer customers, that don't have any personal computing experience" (Rose 2/18/99pm, at 45:25 - 48:14) supports Decker's testimony that Compaq removed Navigator because with Internet Explorer, the category was filled.
- ii. Microsoft points to documents which show only that AOL might have objected to Compaq's bundling of Netscape with another Internet access provider, not that AOL would have objected to Compaq's inclusion of Netscape (or another browser) in other ways. DX 2261, at COM-13-000040 (Compaq-AOL agreement) (Compaq's obligation was to feature the AOL service and GNN (defined in the agreement as a "direct Internet service provider," not a browser) "above all other Online Services within the user interface of its Products in accordance with the attached addendum"; the addendum refers only to "online services" and "online services folder," not to browsers) (emphasis added).
- iv. Moreover, nearly all the documents relied on by Rose, in support of his assertion that Compaq's removal of Navigator was in response to AOL, in fact support the conclusion that AOL's complaints were limited to other online service/ISPs, not browsers, and did not directly apply to Compaq's positioning of Netscape as a separate application. DX 2376 (5/13/96 letter from Ted Leonsis of AOL to Celeste Dunn) ("The terms were set to insure that both services were featured in their respective categories, AOL as the online choice and GNN as the Internet choice. We believe that the current positioning of Netscape/Spry Internet service does not recognize GNN as the featured product."); DX 2378 (5/22/96 letter from Celeste Dunn to Ted Leonsis of AOL) ("In reviewing our plans for AOL on our new consumer line, I am confident that we have met and exceeded the obligations in our contract for both AOL and GNN. Both AOL and GNN are featured above all other online services as defined in the contract."); DX 2374 (6/3/96

letter from Ted Leonsis of AOL to Celeste Dunn) (“Your letter states ‘since we do not include Internet access in the same category as a full-service online service, we have included an additional Internet service provider icon on our desktop.’ If Compaq is including such an additional icon, then it must go to GNN . . . . Moreover, providing this icon to any other provider, including Netscape bundled with an ISP, would violate part 2 because the language contemplates placement of such a provider in an innocuous (i.e., Other) grouping. Your letter’s reference to reasons for GNN not occupying this spot are, frankly, unacceptable -- we do not see where Netscape’s browser fits into our agreement except that where it is bundled with an ISP (other than GNN), the two are to be relegated to the ‘Other’ grouping.” (emphasis added)).

180. The prohibition on removing the Internet Explorer icon similarly increases the costs to end users of standardizing on a non-Microsoft browser because of increased support costs and thus reduces the value of Windows to those customers.

- i. See supra Part V.B.4.c; ¶¶ 169-170.
- ii. Boeing’s Scott Vesey explained that “[h]aving two web browsers on the desktop will confuse users” and increase support costs. GX 637. “End user confusion,” he explained, could manifest itself in several ways, including, “applications or sites that require a particular browser,” “specific configuration settings” that do not “work within one browser or the other,” or “an expectation that . . . a particular browser would function in a particular way . . . based on experience.” Vesey Dep., 1/13/99, at 290:4-21. Vesey further testified that, to encourage the use of a single browser, Boeing “probably would” delete the desktop icon of the second browser. Vesey Dep., 1/13/99, at 289:13 - 290:3. (explaining that to avoid these costs, large end-users end up paying firms to remove the Internet Explorer icon in order to enforce a corporate standard on another browser, a cost they need not bear if they standardize on Internet Explorer).
- iii. Glenn Weadock testified that eliminating clutter can reduce end user confusion. Weadock, 11/17/98am, at 34:16 - 35:3.

181. Microsoft’s prohibition on altering the start-up sequence also impeded Netscape’s ability to promote its browser because the Windows start-up sequence is an important point of contact with the features and software available on a PC.

- i. Garry Norris testified that IBM concluded, based on usability studies, that its “Welcome Center” features was much less likely to be used if it were merely one of many icons on the Windows desktop. Norris, 6/7/99pm, at 58:4-20.
- ii. Hewlett-Packard’s John Romano testified that an icon on the desktop is not as “effective” as placement in boot-up sequence. Romano Dep. (played 12/16/98pm), at 54:13 - 55:7.
- iii. Microsoft’s Steve Bush expressed concern that OEMs, if permitted to supply their own registration mechanism, could “interject themselves into the first boot customer experience and offer customers valued added services before a Microsoft proposition of similar services.” GX 313.
- iv. Kempin wrote that it was vital to Microsoft’s “strategic objectives” to “ensure that no other advertising other than promoting the OEMs name brand can be done during this ‘extended’ boot process.” GX 304.
- v. Microsoft employees expressed concern that a Windows tutorial program “won’t attract end users’ or OEMs’ attention” if it is “not part of the boot sequence or in a very prominent position.” GX 742.
- vi. Microsoft moved its Internet Connection Wizard from the desktop to the start-up sequence in Windows 98 because it believed it would be more likely to be used in the start-up sequence. “Adding the ICW (Internet Connection Wizard) to the welcome experience should help drive up the percent of new internet sign-ups which originate from Windows.” GX 764, at MS98 0114749; see also McClain Dep., 1/13/99, at 622:22 - 623:4 (conceding that users are “less likely to invoke the Internet Connection Wizard from the desktop” if they have already accessed it from the “Welcome to Windows’ screen”); id. at 625:10-20 (conceding that having the signup screen appear before the “Welcome to Windows” screen “forces the customer to go through that option”); GX 176 (“In order to protect our position on the desktop and increase the likelihood that IE gets the prominent position with the end user we should move the Sign Up Wizard into the boot up sequence some where.”).
- vii. John Soyring of IBM, who noted that he is “quite familiar with computer operating systems,” testified that only end users with sufficient technical skills are able to reconfigure their machines so that they boot up directly into an alternate browser shell. When Soyring himself tried it with an IBM Thinkpad, the browser was on the machine’s hard drive and not in “an obvious place for me.” He “searched through some folders to find it,” and it took some time. Soyring, 11/18/98pm, at 18:2 - 19:18.

viii. Dr. Warren-Boulton testified that “the start-up sequence is a particularly effective vehicle for promoting software or services, especially for firms interested in promoting their services to first-time PC purchasers.” Warren-Boulton Dir. ¶ 122. He further explained: “The principal reason why it is advantageous to have a ‘first to market position’ in the boot-up sequence is simple: It is apparently quite difficult to induce new browser users to switch to a competing browser” a fact “confirmed by Microsoft’s own documents, which conclude that ‘it is very hard and expensive to make people switch [browsers].’” Warren-Boulton Dir. ¶ 123 (quoting GX 39).

182. Microsoft’s restrictions reduced OEMs’ ability to promote Netscape in other ways.

- i. Dr. Warren-Boulton testified that Microsoft’s prohibition on OEMs automatically booting their PCs into an alternative OEM shell, the original impetus for the Windows Experience, inhibited OEM efforts to highlight other browsers over Internet Explorer. Warren-Boulton Dir. ¶¶ 177-78.
- ii. Professor Fisher testified that Microsoft’s prohibition on changing the size and shapes of icons further has “the effect . . . to limit the ability of OEMs to promote other browsers by, for example, highlighting the existence of another browser with a large desktop icon.” Fisher Dir. ¶ 148.

183. By raising the costs to OEMs and end users of employing alternative browsers, and by preventing OEMs from booting directly into alternative OEM shells, Microsoft’s restrictions facilitated the protection of its operating system monopoly.

- i. See infra Part V.A.2.b; ¶¶ 362-363.

184. Microsoft’s restrictions caused other substantial consumer harm.

- i. Microsoft’s restrictions compelled OEMs to remove tutorial programs, auto-booting alternative OEM shells, and other features that permitted OEMs both to differentiate their products and to make the PCs they sell easier to use. See supra ¶ 179.1.
- ii. Microsoft’s restrictions resulted in a dramatic increase in OEM support costs (see supra ¶ 179.1), which both indicates substantial consumer confusion and which, in the competitive market in which OEMs sell, can be expected to be passed on to consumers in the form of higher prices.



- iii. Microsoft's restrictions constrained users' choice of web browsing software and made more costly their ability to standardize on a particular web browser. See supra ¶ 179.1.

185. Microsoft's contention that its restrictions have not materially raised the costs to OEMs of featuring Netscape Navigator or otherwise impeded Netscape's ability to gain promotion and distribution through the OEM channel is unpersuasive.

185.1. Testimony by Microsoft's witnesses, in particular Dean Schmalensee, that Microsoft's contracts permit OEMs to promote other browsers on the portion of the Windows desktop that Microsoft permits OEMs to control (Schmalensee Dir. ¶ 358 ("OEMs can add any additional programs they wish, including Web-browsing software."); see also id. ¶¶ 361-63; Kempin Dir. ¶ 19) ignores the ways in which Microsoft's contracts in practice raise OEMs' costs of including other browsers and thereby, as a practical matter, deter OEMs from doing so.

- i. Dean Schmalensee conceded that OEMs in practice take advantage of only "a small fraction of the Windows desktop available to them." Schmalensee Dir. ¶ 365; DX 2163 (Kempin's videotape demonstration); A Gateway Account Manger also admitted that OEMs do not add many icons to the Windows desktop. McClain Dep., 1/13/99, at 615:13 - 616:14.
- ii. As explained, including icons for additional products — particularly when a comparable product in the same category is already included, as is the case for browsers — imposes significant, and in some cases prohibitive, costs. See supra ¶ 179.1.

185.2. Microsoft's argument that any raising of rivals' costs is insubstantial because a number of OEMs install multiple browsers, including the Encompass browser and Netscape Navigator (Kempin Dir. ¶¶ 21-22 (testifying that "a number of major OEMs . . . currently preinstall Netscape's web browsing software" and that "more recently, leading OEMs . . . have begun installing browsing software developed by Encompass, Inc.")), is wrong.

185.2.1. First, the Encompass browser is not a true web browser, but rather consists of a shell that is built “on top” of Internet Explorer and relies on Microsoft’s APIs. Microsoft allows OEMs to customize such shell browsers in conjunction with ISPs. The costs to OEMs of supporting the Encompass browser and thus are lower than the costs to OEMs of supporting Netscape while not being permitted to remove the Internet Explorer icon.

- i. Kempin’s videotape (DX 2163) shows several OEM-customized Encompass browsers. OEMs collect most of the ancillary revenues from this product. See infra Part V.G.6.b; ¶ 313.2.2.1.
- ii. Dr. Warren-Boulton explained that the contrast between Microsoft’s sacrifice of ancillary revenues, through its shell-browser, and Netscape’s efforts to collect such revenues “is a nice example of the distinction between what Netscape is trying to do in the browser market, which is to make money, and what Microsoft’s trying to do in the browser market, which is to control the technologies.” Warren-Boulton, 12/1/98am, at 14:8-11.

185.2.2. Second, even though some OEMs continue to offer Netscape on some of their PCs, the OEM restrictions caused the number of OEMs offering Netscape, and the number of PCs on which they offered Netscape, to decline.

- i. See infra Part VII.A.2.b; ¶ 363.4.

185.3. Mr. Kempin’s testimony that OEMs could run another operating system prior to initiation of the Windows start-up sequence without running afoul of Microsoft’s restrictions, and could feature a rival browser either there or in the “BIOS” -- the software that turns on the computer and runs prior to invoking Windows (Kempin ¶ 43 (license agreement allows OEMs to “run a small operating system such as Caldera’s DR-DOS from the BIOS before Windows starts, and launch all sorts of programs”)) -- ignores the evidence from OEMs and

Microsoft that extensive customization through either of these mechanisms would have been too costly to be a practical alternative.

- i. John Romano testified that Hewlett Packard did not place its Personal Page Program before the boot-up sequence because of the “cost and time” in creating a “technically viable” program. Romano Dep., 12/16/98pm, at 42:12 - 44:2.
- ii. A Microsoft document from “Brad Chase’s Online files” concludes that “most OEMs won’t go through the hassle to develop” a utility that runs before Windows boots. GX 176A.
- iii. Each OEM featured in Joachim Kempin’s videotape had only a brief “splash screen” in the BIOS. DX 2163.
- iv. Compaq’s Celeste Dunn testified that the BIOS “supports the hardware peripherals” and that “to run things like commercials or other things” in the BIOS one would need “to have the resources of the full operating system available to you, plus the things supported by the BIOS.” Dunn Dep., 10/23/98, at 190:15 - 191:6 (DX 2566).

185.4. While Microsoft witnesses stress that OEMs are permitted to include icons on the desktop that enable the user, with a few mouse-clicks, to install Netscape as the default browser or to launch an alternative desktop featuring Netscape that appears each time the user subsequently boots the PC (Kempin, 2/24/99am, at 70:13-19 (testifying that “the OEM is free to display whatever it wishes, and can even replace the Windows 98 desktop entirely”)), these options are substantially less cost-effective for both OEMs and non-Microsoft browser providers than the options Microsoft blocked.

- i. Hewlett-Packard dropped its alternative OEM shell because it “was not as effective of a way to” reach customers when placed “after the bootup sequence”; on the desktop, “there was much less likelihood” that consumers would successfully invoke it. Romano Dep. (played 12/16/98pm), at 37:1-8, 54:7-22.

ii. End users are much less likely to obtain the browser they use through these methods than through the channels Microsoft foreclosed. See infra Part VII.A.2.c; ¶ 366.

**c. Microsoft's recent relaxation of some of its restrictions eliminates neither the most anticompetitive restrictions nor the restrictions' past effects**

186. Microsoft over time relaxed certain requirements of the "Windows Experience."

- i. In approximately March 1998, Microsoft permitted some 50 OEMs to include the ISPs of their choice in Microsoft's Internet Connection Wizard. Kempin Dir. ¶ 12.
- ii. Through letters issued in late May and early June 1998, Microsoft granted seven OEMs the right to add their own Internet Connection Wizard and registration server to the boot-up process. Kempin Dir. ¶12.
- iii. Microsoft permitted certain OEMs to include other features in the start-up sequence. GX 1121, at MSV 000752 (sealed)

GX 1201 (Windows 98 OPK), at  
MS98 0102861-62 (describing the limits on OEMs' ability to customize the  
Windows desktop and start-up sequence).

187. These changes, however, do not eliminate the restrictions' anticompetitive character.

187.1. First, the restrictions had a substantial effect when in place.

- i. See infra Part VII.A.2.b; ¶ 363.

187.2. Second, these changes did not remove the restrictions that most significantly raise the costs to OEMs of featuring Netscape, such as the prohibition on removing

the Internet Explorer icon from consumer systems, the prohibition on providing alternative OEM shells that load automatically at the end of the start-up sequence, and restrictions on featuring Netscape.

- i. Microsoft's letters to the OEMs allowed them to add their own registration wizard and ISP sign-up process provided that such features "shall contain no third party advertising or product promotions other than those from the [OEM] or the ISP being signed up." *E.g.*, GX 1195, at MS98 011385 (Letter to Packard Bell/NEC May 27, 1998).
- ii. Kempin testified that OEMs may feature both Internet Explorer and OEM-branded browser shells built on top of Internet Explorer, but they are barred from featuring a third-party browser, such as Netscape, in the ISP sign-up process. Kempin, 2/25/99am, at 6:1-15.
- iii. Although Kempin at one point testified that OEMs were barred only from advertising Netscape, not from providing a choice of Netscape (Kempin, 2/25/99am, at 13:12 - 17:16), he testified both earlier and under questioning from the Court that Microsoft's letters prohibited OEMs from offering Netscape in the ISP sign-up process. Kempin, 2/25/99am, at 6:1-15; Kempin, 2/26/99am, at 11:5 - 12:9.

187.3. Although Microsoft has subsequently granted one OEM, Gateway, permission to offer users the choice of Netscape in the Gateway.net ISP sign-up process (Kempin, 2/26/99am, at 5:22 - 8:13), Microsoft continues to make that option costly by prohibiting Gateway from removing the Internet Explorer icon.

- i. Microsoft continues to prevent Gateway from removing the Internet Explorer icon. *See supra* ¶ 179.1.
- ii. Gateway executives testified that it now offers the Netscape option only to Gateway customers who preselect Gateway.net as their ISP and pay subscription fees that offset some of the costs caused by the inability to remove the Internet Explorer icon. Brownrigg Dep., 1/13/99, at 126:6 - 128:1; Von Holle Dep., 1/13/99, at 311:21 - 312:21.

**d. Microsoft's justifications for its restrictions are pretextual and belied by the evidence**

188. Microsoft's witnesses, principally Joachim Kempin, advanced a number of justifications for its OEM restrictions. These justifications are inconsistent with Microsoft's actual conduct and the contemporaneous evidence and are pretextual.

**(1) Microsoft's purported concern with consistency of the user experience cannot explain its restrictions**

189. Microsoft's suggestion that its restrictions preserve a "consistent experience" for end users (Kempin Dir. ¶ 10) is not credible because Microsoft allows OEMs to take numerous actions that are inconsistent with its professed interest in preserving a "consistent experience."

- i. Microsoft permits OEMs to ship Windows 98 with the Active Desktop and its channels either on or off. Poole, 2/8/99am, at 11:14-17 (DX 2115, Poole's videotape demonstration). The experience of a user booting up a machine with the Active Desktop (including the channel bar) enabled could be very different from that of a user booting into the "standard" Windows desktop.
- ii. Microsoft permits several OEMs to customize the Windows start-up sequence in various ways, so that each PC presents users with a different experience, including, for example, providing very different introductory tutorials, OEM-related advertisements, and registration screens. DX 2163 (Kempin video). Compaq even has a lengthy "movie" promoting Compaq in the start-up sequence. DX 2163.
- iii. Microsoft permits the largest OEMs to include their own Internet Connection Wizard in the start-up sequence. Kempin Dir. ¶¶ 57-58.
- iv. Microsoft itself recognizes that its conduct is inconsistent with its effort to justify the restrictions; as one Microsoft employee wrote upon learning that Kempin had granted OEMs greater flexibility with respect to the start-up sequence, "the reaction from **DaveHe and the antitrust team was negative**. Changes like this undermine our whole case in defense of Windows Experience." GX 379 (emphasis in original).
- v. When Microsoft permits OEMs to promote products more prominently than Internet Explorer, it specifically prohibits OEMs from promoting third party

brands, including Netscape. GX 1201 (no third party branding in the Active Desktop); GX 1159, at TM 000057 (OEMs cannot advertise or promote third party branding in ICW or reg. wizard in boot-up sequence). This distinction between OEM brands and third party brands has no relationship to the “consistent experience” of end users because different OEMs promote their brands in different ways. DX 2163 (Kempin video).

- vi. Kempin testified that Microsoft prohibits third party advertising in the ISP sign up process because that “process . . . should not be interrupted by any advertising.” Kempin, 2/24/99pm, at 79:18-19 (emphasis added).

1190 (sealed), at MS98 008924;

Warren-Boulton Dir. ¶ 175.

- vii. Kempin elsewhere made clear that Microsoft’s purported concern with “consistency” easily gives way when Microsoft seeks to accomplish its “strategic” goals. GX 304. Although Microsoft told OEMs that “all OEM’s of Windows 95 are treated equally by” Microsoft “in meeting the same OPK requirements for shipping Windows 95 PC’s to ensure the customer of a consistent experience” (GX 294), in practice Microsoft favored Compaq by permitting it to customize the start-up sequence in Windows 95 in ways it denied to other OEMs (Romano Dep. (played 12/16/98pm), at 52:10 - 54:9), and by permitting it to include its own ISP sign-up process before other OEMs were allowed to do so. Kempin, 2/24/99pm, at 42:22 - 43:9.

190. In light of this real-world conduct, there is no reason to conclude that Microsoft’s OEM restrictions were intended to, or did, preserve a consistent user experience.

- i. “The fact that Microsoft has granted exceptions to these restrictions to certain OEMs suggests that the concern for quality, speed, and consistency is not Microsoft’s primary motive for enforcing these restrictions.” Fisher Dir. ¶ 166.
- ii. By allowing OEMs to vary the user’s initial experience in significant respects, “Microsoft makes plain that maintaining a consistent user experience is a minor concern and easily gives way when OEMs create value by differentiating their products: for example, by pre-installing a particular set of applications. There is no reason why it should not similarly give way when OEMs believe that end-users will find their machines more attractive when they come with a non-Microsoft browser, rather than Internet Explorer, pre-installed.” Warren-Boulton Dir. ¶ 161; see also Warren-Boulton Dir. ¶¶ 171-78.

- iii. Although Dean Schmalensee testified that Microsoft's consistency concern is "plausible" (Schmalensee, 1/20/99am, at 22:13 - 23:6) he investigated neither the actual decisionmaking process that led to the "Windows Experience" nor Microsoft's pattern of granting and denying exceptions. Schmalensee, 1/20/99pm, at 26:17 - 27:3, 35:3-14.

**(2) Microsoft's purported concern with protecting product quality and goodwill cannot explain its restrictions**

191. Microsoft's argument that the challenged OEM restrictions were designed to preserve the quality of Windows and protect Microsoft's goodwill (Kempin Dir. ¶ 32, 36-38) cannot withstand scrutiny.

191.1. First, the restrictions are not necessary to induce OEMs to preserve Windows' quality.

- i. OEMs, which pay customer support costs and operate in a competitive market (Norris, 6/7/99pm, at 59:16-24) have no incentive to supply alternative OEM shells, remove icons, or to modify the boot-up sequence if doing so makes their PCs less attractive to users. Warren-Boulton Dir. ¶¶ 83-88, 160, 181.
- ii. Although Dean Schmalensee vaguely alluded to literature on "channel conflict" (Schmalensee 1/20/99am, at 32:9-12; Schmalensee, 6/21/99am, at 38:9 - 40:10) the evidence in fact shows the absence of "the kind of conflict of interest" between Microsoft and OEMs regarding the quality of Windows that might lend credibility to Microsoft's testimony. Warren-Boulton, 11/30/98pm, at 57:3 - 58:8; Norris, 6/7/99pm, at 69:3-20 (testifying that IBM "would be impacted" were it to offer a "confusing or poor" user experience).

191.2. Second, that Microsoft's quality control justification is pretextual is also shown by the fact that Microsoft permits OEMs to take any number of actions that could jeopardize product quality.

- i. Microsoft permits OEMs to preinstall the third-party software of their choice (including lengthy tutorials, ISP sign-up and registration mechanisms) and other features in the start-up sequence, as well as user-



activated features of all sorts (such as alternative OEM shells). Kempin Dir. ¶¶ 17-22, 46.

- ii. Many of these features require significant technical sophistication on the part of OEMs to implement, and the operation of any of them could create technical problems for which the user could hold Microsoft responsible. Soyring Dir. ¶¶ 20-22.

191.3. Third, other OS vendors — which lack Microsoft’s monopoly power, and thus its ability and incentive to use licensing restrictions for strategic purposes, and have even greater incentive to meet consumer demand — do not impose the type of restrictions Microsoft mandates.

- i. IBM permits licensees of its OS/2 operating system to customize its screen displays extensively. Soyring Dir. ¶¶ 31-33; see also Soyring, 11/18/98pm, at 80:19 - 81:19 (noting that IBM imposes some restrictions, but “gives” OEMs “a great deal of freedom in choosing which functions are either installed or used and what the appearance of the screen would be”). In contrast to a Windows licensee, an OEM licensing OS/2 “could override the entire desktop in favor of a customized desktop or could set an application to start automatically when the machine turns on.” Soyring Dir. ¶ 31. IBM has experienced “no erosion of . . . goodwill” or other ill-effects from permitting OEMs such flexibility. Soyring Dir. ¶ 32.
- ii. Apple similarly permits value added resellers to remove applications and reconfigure the Apple desktop. Tevanian Dir. ¶ 26; see also Limp Dep., (played 12/16/98am), at 32:24 - 33:21.
- iii. Smaller operating system vendors often ignore restrictions on OEMs set forth in their contracts because they recognize that it is “in the[ir] best interests . . . to give [the OEMs] as much freedom as possible.” Warren-Boulton, 11/30/98pm, at 58:4 - 59:1.

191.4. Fourth, Mr. Kempin’s testimony about preserving product quality was contradicted by other, more reliable evidence, as well.

- i. His own videotape shows several perfectly well functioning alternative OEM shells. DX 2163.

- ii. Evidence showing that Microsoft imposed the Windows Experience not because (as Kempin testified) it discovered that OEM shells were poor (some were, but many were not) but rather because it discovered, in Bill Gates' words, that OEMs were bundling "non-Microsoft browsers and coming up with offerings together with Internet Service providers that get displayed on their machines in a FAR more prominent way than MSN or our Internet Browser." GX 295. See supra Part V.C.1.a; ¶ 177.2.
- iii. Evidence that Microsoft does not prohibit OEMs from taking numerous other actions, including preinstalling inferior software, that could reduce product quality. Soyring Dir. ¶¶ 20-22.

191.5. Fifth, Mr. Kempin's testimony itself was evasive, inconsistent, and not believable.

- i. Although Kempin testified that the Windows Experience was intended to prevent OEMs from "tampering" with Windows (Kempin, 2/24/99pm, at 60:10 - 61:21; Kempin, 2/25/99am, at 25:4-9), he later admitted that he meant by these terms doing anything Microsoft had not approved. Kempin, 2/25/99am, at 57:21 - 61:20; Kempin, 2/24/99pm, at 67:18 - 68:3.
- ii. Kempin testified that Windows would not function if Internet Explorer were removed but, when pressed, conceded that he lacked any pertinent technical knowledge. Compare Kempin Dir. ¶¶ 4-6, 66-68 with Kempin, 2/24/99pm, at 90:3 - 93:18 (Kempin does not know how add/remove works); Kempin, 2/25/99am, at 66:21 - 68:25 (Kempin does not know how technically integrated Internet Explorer 1 and 2 were with Windows); Kempin, 2/25/99pm, at 5:2 - 10:2 (Kempin does not know the degree of technical integration of Internet Explorer technologies). See also Kempin, 2/25/99pm, at 69:16 - 70:18 (Kempin claims that Internet Explorer has to launch in certain instances in Windows 98 for technical reasons, but Kempin cannot recall those reasons).
- iii. Kempin testified that Microsoft's Windows 95 licenses always prohibited OEMs' configuring programs to run automatically at the end of the start-up sequence, including booting directly into alternative OEM shells (and, therefore, that this restriction was not first imposed by the Windows Experience in 1996-97). Kempin, 2/25/99am, at 24:9 - 26:24. But the very document he cited for that proposition says precisely the opposite. DX 2395; see also Kempin, 2/25/99pm, at 37:13 -38:13 (conceding Microsoft decided "not to allow OEM shells to interrupt the Windows 95

and NT boot cycles” in the spring of 1996 (quoting GX 1883)). Nor could Kempin credibly explain why, if Microsoft never granted OEMs that right, it used MDA provisions to induce OEMs to keep the standard Windows desktop instead of simply enforcing its licenses. Kempin, 2/25/99am, at 24:3 - 27:22.

- iv. Kempin denied that Gates, in writing that “[a]pparently a lot of OEMs are bundling non-Microsoft browsers and coming up with offerings together with Internet Service providers that get displayed on their machines in a FAR more prominent way than MSN or our Internet Browser”(GX 295), was “necessarily” “concerned with Netscape” (Kempin, 2/25/99am, at 19:5-10), a reading that is wholly incredible.
- v. Kempin’s testimony concerning whether Microsoft’s letters authorizing OEMs to include an ISP sign-up process in the boot-up sequence prohibited offering Netscape in the start-up sequence was contradictory. See supra ¶ 187.2.
- vi. Kempin testified that Microsoft’s restrictions reflect terms “quite common in the software industry (with the exception of UNIX software vendors),” Kempin Dir. ¶ 25; but the evidence shows the opposite. See supra ¶ 191.3.

192. Mr. Kempin testified that lifting the challenged restrictions would “degrade”

Windows and “limit[] end user choice” (Kempin Dir. ¶¶ 39, 13), but that testimony cannot be credited because it is inconsistent with the evidence.

- i. Microsoft required IBM to scrap its introductory screens, including its Welcome Center feature, despite the fact that Microsoft thought it “enhanced the user experience” and never raised any concerns regarding its quality. Norris, 6/7/99pm, at 62:25 - 63:25. What degraded Windows, therefore, was not OEMs’ conduct, but Microsoft’s own restrictions.
- ii. The evidence shows that permitting OEMs to remove the Internet Explorer icon would increase choice by reducing the costs to OEMs of preinstalling rival browsers that their customers might demand, see supra ¶¶ 179-180, and would thereby increase the quality of Windows to those customers. Kies Dep., 1/13/99, at 7:16-20 (explaining that the ability to remove the Internet Explorer icon pursuant the Stipulation entered by this Court on January 18, 1998, enhanced the value of NEC’s notebook line of computers to corporate customers, who generally “prefer[] to receive only the base OS and drivers and not have any of the other third-party applications pre-installed”).

- iii. Microsoft itself recognized this

GX 227 (sealed). Dell executive Joseph Kanicki testified that Dell wanted this freedom so that it could offer higher value to end users by permitting customers standardizing on a non-Microsoft browser to remove the Internet Explorer icon. Kanicki Dep., 1/13/99, at 339:13 - 342:1.

193. Microsoft witnesses' related argument -- that consumers would be disappointed not to find on their PCs features Microsoft promotes (Kempin Dir. ¶ 42) -- is also inconsistent with the evidence.

- i. Microsoft permits OEMs to ship PCs with the Active Desktop and its associated "channels" inactive (and without any warning to customers). GX 231.
- ii. Consumer expectations could in any event be met by the significantly less restrictive alternative of a labeling requirement, pursuant to which OEMs could be required to tell their customers when particular PCs include non-standard features. Warren-Boulton, 12/1/98, at 39:6 - 40:10; see also Warren-Boulton Dir. ¶¶ 177, 181.

**(3) Microsoft's restrictions are unrelated to its purported concern of preventing fragmentation of the Windows platform**

194. Microsoft's witnesses said that lifting the restrictions challenged by the plaintiffs would result in different "flavors" of Windows, thereby "destroy[ing]" "one of the central reasons for the appeal of Windows among customers and developers -- that it provides a stable, coherent platform for software development" (Kempin Dir. ¶ 30; see also Warren-Boulton Dir. ¶ 31; Maritz Dir. ¶¶ 167-70); but none of these witnesses explained how any of the OEM desktop or start-up restrictions has anything to do with protecting the stability or coherence of the Windows platform.

194.1. None of the OEM restrictions was needed to protect the platform because the stability of the platform depends only on the stability of the APIs and the OEM restrictions were aimed at conduct that did not involve removal or alteration of APIs.

- i. Neither removing the Internet Explorer icon nor permitting programs to run at the end of the start-up sequence nor modifying the start-up sequence need involve removing or altering APIs. Felten Dir. App. B, at 14 (removing the Internet Explorer icon requires simply changing a few registry entries).
- ii. There is, moreover, obviously less restrictive alternative that “restricts or prevents only those modifications . . . that impair the ability of ISVs to access the APIs provided by the Windows.” Warren-Boulton Dir. ¶ 180.

194.2. Even if OEMs were contractually free to remove or alter APIs, Microsoft’s concern about platform fragmentation would still provide no justification for the OEM restrictions.

- i. In the first place, OEMs have no incentives to take actions that may make Windows less valuable, such as removing APIs that customers want. Warren-Boulton Dir. ¶¶ 179, 181.
- ii. Moreover, Microsoft itself routinely undermines the stability of its platform with its frequent Internet Explorer updates. Fisher, 6/3/99am, at 21:24 - 22:14.
- iii. In any event, most ISVs find it necessary to redistribute the Internet Explorer APIs themselves (thus ensuring a stable platform) because of existing nonuniformity in the Windows installed base and Microsoft’s frequent Internet Explorer updates. “Microsoft’s API’s are not, in fact, stable. They change. And ISV’s have to keep embedding pieces of the appropriate API’s into their own software in shipping it out.” Fisher, 6/3/99am, at 22:8-14; supra Part V.B.3.d(2); ¶ 164.

**2. Microsoft used its monopoly power to force OEMs into taking actions to hinder products or industry developments that threatened its operating system monopoly**

195. Microsoft used its monopoly power both to coerce OEMs into taking actions that furthered its exclusionary strategy and to punish OEMs that refused.

**a. Microsoft used threats and bribes to induce OEMs to help entrench its operating system monopoly**

196. Microsoft used its monopoly power, both through threats and bribes to OEMs, to entrench its operating system monopoly.

**(1) Microsoft used its monopoly power to secure Compaq's assistance in its exclusionary strategy**

197. Compaq, the largest OEM in the United States, has been aware for years that Microsoft has the power to damage its personal computer business because Compaq lacks any practical alternative to Windows.

- i. John Rose's testimony emphasizes the importance of Microsoft's operating system to Compaq's business. See Rose Dir. ¶ 17 (Compaq loads only Windows on consumer PCs because it believes that's what consumers want); Rose, 2/17/99pm, at 41:4-11 (despite increase in price of Microsoft operating systems in 1998, Compaq has not evaluated any other operating systems for preinstallation on desktop PCs); Rose, 2/17/99pm, at 64:19-22 (cancellation of Windows license would be "of great concern" to Compaq), see also Dunn Dep., 10/23/98, at 37:24 - 39:15 (DX 2566) (Celeste Dunn, a former Compaq executive, explained there were no alternatives to Windows during her tenure at Compaq).
- ii. A Compaq presentation entitled "Microsoft Meeting Preparation — Portable and Software Marketing PC Division,"

- “Judgment: How retaliatory would they get?: Pricing advantage — Revenue from updates — Access to early SDKs — Field sales activities (Microsoft has ~900 field sales people) — Support and training — Inclusion in advertising — Tone toward Compaq in press and with customers — Selection and elevation of other OEMs as leaders — Make integration relations even more strained than they are today — Access to source code, modification ownership — Microsoft directional information and plans — Customers.” GX 433, at slide 8 (sealed).

iii.

iv. See also supra Part II.A; ¶ 15.1.2 (detailing evidence that Compaq has no commercially viable alternative to Windows).

198. Compaq recognizes that it has a \_\_\_\_\_ with Microsoft.

v. Rose conceded at trial that Microsoft's relationship with Compaq is different from its relationship with other OEMs. Rose, 2/18/99am, at 10:1-18.

vi.

199. Microsoft has frequently granted Compaq more favorable terms than other OEMs as a result of Compaq's acquiescence in Microsoft's exclusionary strategies and because of the

199.1. In 1992, Microsoft granted Compaq a five-year "Frontline Partnership" license agreement, covering the years 1993 through 1998,

i. As Professor Fisher summarized:

Fisher, 1/11/99am, at 20:12-18 (sealed session).

ii.

GX 451 (sealed); GX 449, at MSV 0002626-29 (1992 Frontline Partnership agreement) (sealed); Rose, 2/18/99pm, at 92:24 - 93:10 (sealed session).



iii.

- iv. Compaq executive Bob Jackson noted in a December 1994 e-mail to other Compaq executives: “A major piece of value in the agrmt [sic] is they cannot raise the price on us, which I believe they can do in all other agreements.” GX 135; Rose, 2/19/99am, at 46:18-22 (from 1992 through 1998, Compaq’s Windows royalty “didn’t go up at all”)

199.2. Microsoft granted Compaq the significant competitive advantage of being able to verify that its prices were lower than those charged its competitors, and Compaq received confidential information about other OEMs’ prices.

- i. An internal Compaq memorandum to its CEO, Eckhard Pfeiffer, in January 1995 states: “Jan Claesson is Microsoft’s new OEM Group Manager for the Compaq account and reports to Joachim Kempin . . . .” GX 230, at 5812. “Jan provided very confidential information about Windows 95 royalties in regards to other OEMs. The bottom-line was that Compaq still has a significant price advantage.” GX 230, at 5816 (sealed).
- ii. Kempin conceded that GX 230 shows that Claesson provided Compaq confidential information. Kempin testified that if he would have “known this at that point in time, I think Mr. Claesson would have gotten fired.” Kempin, 2/25/99pm, at 107:17 - 108:19.

200. When Compaq acted contrary to Microsoft’s strategy to gain browser usage share in 1995, Microsoft wielded its monopoly power to coerce Compaq into both distributing and highlighting Microsoft’s products and excluding Microsoft’s rivals.

200.1. As early as late 1994, Compaq executives recognized that it was in Compaq’s interest to be able to choose among competing online services and other Internet software on the merits.

- i. In a December 1994, internal e-mails discussing Compaq’s negotiations for Windows 95, Compaq executive Vaughn Rhodes wrote: “I strongly

recommend that we take the position of negotiating distinctly for the MS network . . . . Compaq should have each online service (America Online, MS Network, Prodigy, etc.) prepare a proposal which indicates what they can offer Compaq . . . . Compaq can then evaluate each proposal on its own merits . . . .” GX 135.

200.2. In connection with the release of its new consumer line of PCs in late 1995/early 1996, Compaq removed the Internet Explorer and MSN icons from the Windows 95 desktop screen in order to feature Netscape and certain AOL software.

- i. As Rose acknowledged: “I understand that, in early 1996, Compaq did remove, on some consumer products, the Internet Explorer icon (as opposed to Internet Explorer software) from the Windows 95 default desktop on its Presario line of personal computers.” Rose Dir. ¶ 25.
- ii. Rose also acknowledged that Compaq had a strategy to feature Netscape along with AOL. Rose, 2/19/99am, at 64:14-23.
- iii. Celeste Dunn, Compaq’s former Vice-President of the Consumer Software Business Unit with responsibility for software decisions on the Presario product line, testified that she believed at the time that featuring Netscape, which had “brand name recognition that the consumer could equate value to,” would benefit Compaq, but that Compaq “probably would not want to feature the Netscape browser” if Compaq had to give favored treatment to Internet Explorer and MSN. Dunn Dep., 10/23/98, at 92:1 - 94:5 (DX 2566).
- iv. Dunn had contemporaneously emphasized the importance of highlighting Netscape Navigator in an internal May 1996 e-mail raising concerns about agreeing with Microsoft to display the Internet Explorer and MSN icons and make Internet Explorer the default browser: “In regard to browsers, our goal is to feature the brand leader Netscape . . . .” GX 299.
- v. Stephen Decker, Compaq’s Director of Software Procurement, also testified that Compaq’s removal of the Internet Explorer icon reflected Compaq’s commitment to Netscape. He testified that Compaq wanted to remove the Internet Explorer icon because “at the time, we had a relationship with Netscape and we had been shipping their product for a while. And, therefore, Netscape was actually the browser partner and we wanted to give that position on the Compaq Presario desktop.” Decker Dep., 2/18/99am, at 47:19-25.

- vi. Microsoft's account managers responsible for dealing with Compaq also testified that Compaq removed the icons in order to highlight AOL and Netscape software. Williams Dep., 1/13/99, at 792:4-21 (Compaq executives told Microsoft that they wanted to remove the MSN and Internet Explorer icons because it would make it easier to promote their other partners.); Hardwick Dep., 8/11/98, at 38:4 - 40:7 (DX 2570) (Microsoft OEM representative understood from Compaq employees that Compaq removed the Internet Explorer icon so that Compaq could earn a bounty from Netscape for being the only browser).

200.3. In May 1996, Microsoft responded to Compaq's removal of the Internet Explorer and MSN icons from Compaq's PCs by threatening to terminate Compaq's OEM license unless Compaq restored the Internet Explorer and MSN icons to the desktop.

- i. On May 31, 1996, Peter Miller, an in-house attorney for Microsoft, sent a letter to David Cabello, Compaq's then General Counsel, notifying Compaq of Microsoft's intent to terminate Compaq's operating system license: "It has come to Microsoft's attention that Microsoft Windows 95 is being distributed by Compaq with Compaq Presario systems in a form which has been modified by Compaq. The most notable example is that Compaq has modified Windows 95 by removing the Microsoft Network icon from the Windows 95 'desktop' screen. . . . The Agreement does not grant Compaq any rights to modify Product software . . . or to delete items from Product software. . . . As per the terms of Section 10 'Default and Termination' of the Agreement, this letter is written notice of Microsoft's termination of the Agreement. As per Section 10, termination will be effective thirty (30) days after this notice unless Compaq cures the above violation within the thirty (30) day period." GX 649.
- ii. On June 6, 1996, Microsoft's Don Hardwick followed up on the notice of intent to terminate Compaq's Windows 95 license agreement by sending Compaq a letter offering to withdraw the notice if Compaq restored the MSN and Internet Explorer icons: "Microsoft is requesting that Compaq replace the Microsoft Network and Internet Explorer icons on the Windows 95 desktop on all Compaq Presario machines. Specifically we are asking that these icons be put back on the Windows 95 desktop so they look and function exactly the same as how they were originally provided by Microsoft and/or Authorized Replicators. This means the icons should not be just Windows 95 shortcuts, since the functionality is different. In addition, the Microsoft Network and Internet Explorer icons and Internet

Setup Wizard icon should also be put back into their original locations and functionality under the 'Start' button on Windows 95. If you are willing to give Microsoft a clear written assurance that the above will be implemented on all Compaq Presario machines within sixty (60) days of the date of this letter, Microsoft will withdraw its Notice of Intent to Terminate letter addressed to David Cabello and dated May 30, 1996 once such written assurance is received by Microsoft." GX 650.

200.4. Contrary to the suggestion of Microsoft's witnesses that it was concerned simply about upholding the integrity of the Windows 95 product and its license agreements (Rose Dir. ¶ 30; Hardwick Dep., 1/13/99, at 521:10 - 522:1), Microsoft's actual purpose was to put a stop to Compaq's promotion of rival products and services, including Netscape Navigator, instead of Internet Explorer and MSN.

200.4.1. When Compaq informed Microsoft in advance of its intention to remove the Internet Explorer and MSN icons, Microsoft executives acknowledged that removal of the icons did not affect Windows 95's functioning.

- i. Celeste Dunn of Compaq testified that Microsoft tested Compaq's Windows configuration, and had not detected any technical problems. Dunn Dep., 10/23/98, at 187:12-25 (DX 2566).
- ii. Microsoft's Donald Hardwick testified that he never heard from anyone that Compaq's removal of the Internet Explorer icon had any adverse effects on Windows' functioning. Hardwick Dep., 1/13/99, at 522:2 - 523:4.
- iii. Bengt Akerlind, who was responsible for overseeing Microsoft's relationship with Compaq, also testified he was not aware at the time that Compaq's removal of the MSN and Internet Explorer icons would cause any problems for the rest of Windows. Akerlind Dep., 8/26/98, at 116:4-7 (DX 2603S).

200.4.2. Microsoft's true concern -- that Compaq was assisting Netscape -  
- is evidenced by its strong negative reaction to indications by Compaq that it might support  
Netscape in other ways. For example, in early 1996, when Compaq announced its intention to

work with Netscape for its internal Internet needs and on Internet server initiatives, Microsoft retaliated by initiating cooperative activities with Compaq's competitors and by insisting that Compaq support Microsoft's Internet initiatives throughout its business.

- i. In May 1996, an internal Compaq e-mail by Lori Day reported, with regard to the February announcement of Compaq's partnership with Netscape, that "Microsoft was upset with our announcement and our internal use of Netscape and initiated a number of activities with DEC and HP, reducing their emphasis on the Compaq partnership." GX 298.
- ii. Day went on in the e-mail to report that Compaq was negotiating an extension of the Frontline Partnership to the Internet/Intranet with Microsoft in order to get "realigned" with them. Microsoft insisted, against Compaq's wishes, that the Internet/Intranet partnership should extend throughout Compaq's business lines. Microsoft wanted:
  - "Compaq to ship new versions of Internet Explorer as the default browser on all desktop and server platforms within 8 weeks from release." GX 298.
  - "Compaq to display MSN icon on Desktop screen on all Windows 95 PCs. Compaq and Microsoft to explore other areas of joint activities such as: Promote Internet Explorer activities on Compaq Desktop PCs." GX 298.
- iii. Another internal Compaq e-mail,

- iv. Dunn testified that after receiving the notice of Microsoft's intent to terminate Compaq's operating system license, other senior Compaq executives expressed concern that Microsoft "was not willing to go forth with the finalization of an NT license agreement without having a resolution -- a complete resolution on our -- on our icon issues on the PC platform." Dunn Dep., 10/23/98, at 107:5 - 108:23 (DX 2566).

200.5. Because Compaq recognized that termination of its Microsoft license would mean the end of its PC business, it complied with Microsoft's demands and restored the MSN and Internet Explorer icons to the Windows desktop screen on its Presario PCs.

- i. On June 21, 1996, Compaq gave in to Microsoft's demands. Dunn sent a letter to Hardwick, indicating that Compaq has "made the changes you requested to the Windows 95 desktop of the current release of the Compaq Presario systems. We have replaced the Microsoft Network and Internet Explorer icons on the Windows 95 desktop as executable icons so they look and function exactly the same as how we originally received them from Microsoft and have placed Microsoft Network, Internet Explorer icons and Internet Setup Wizard icons in their original locations under the Start button on the Windows 95 desktop." The letter also pointed out that icons for AOL and for Netscape were on the Windows 95 desktop for Presario systems. GX 645
- ii. On June 25, 1996, Microsoft sent Compaq a letter withdrawing the Notice of Intent to Terminate Compaq's Windows operating system license agreement based on Compaq's representations. GX 301.

200.6. Microsoft's coercion of Compaq to promote Microsoft's Internet software exclusively and to restore the Internet Explorer icon raised the cost to Compaq of featuring Netscape and caused Compaq to remove Netscape Navigator from its Presario PCs.

- i. See supra Part V.B.4.a.1-3; ¶ 167; Part V.C.1.b; ¶ 179.

200.7. John Rose's testimony concerning the events surrounding the removal of the MSN and Internet Explorer icons is inconsistent with both the first-hand accounts of other Compaq executives and the contemporaneous evidence.

200.7.1. Mr. Rose's assertion that Compaq had agreed in August 1995 specifically not to remove icons from Windows 95 is wrong. It is inconsistent with contemporaneous Compaq documents and the testimony of Compaq executives who were personally involved.

- i. Compaq and Microsoft were still discussing whether Compaq would agree to display the icons in May 1996. See supra ¶ 200.3; GX 298 (Lori Day, of Compaq, e-mail dated 5/8/96, stating "we have not agreed" on the proposal that "Compaq to display MSN icon on the desktop on all Windows 95 PCs"); Rose, 2/17/99pm, at 79:15 - 80:10 (Rose was not aware if other top executives at Compaq raised the issue of conflict between GX 298 and any alleged earlier agreement with Microsoft, and did not raise any such issue himself).
- ii. Rose could not explain how his allegation of an August 1995 commitment by Compaq not to remove icons from the Windows desktop was consistent with the behavior of senior Compaq executives at the time.
  - Rose acknowledged that Compaq signed an agreement with AOL in late August 1995 under which Compaq agreed to "position AOL services above all other Online Services within the user interface of its products."
  - Rose further acknowledged that the Compaq/AOL agreement would have been in conflict with what he alleges was an early August 1995 oral agreement by Compaq not to remove the MSN and Internet Explorer icons.
  - And yet, Rose acknowledged, Steve Flannigan, who was Compaq's executive partner in charge of the Microsoft relationship, did not indicate at the late-August time of the

Compaq/AOL deal that the agreement would violate Compaq policy or any pre-existing agreement.

Rose, 2/17/99pm, at 67:3-19; DX 2261, at 1.1.1 (Compaq/AOL agreement, 8/23/95).

iii. Rose admitted that he was not involved in any decisions about the removal of the Windows icons from Presario desktops. Rose testified: "I was not personally involved there, so I couldn't tell you what happened" (Rose, 2/19/99am, at 62:19 - 64:12), but that Celeste Dunn was involved. Rose conceded that "ultimately Celeste was responsible for the software" (Rose, 2/18/99am, at 37:7-11), and that he has "no reason to believe" Dunn's testimony is inaccurate on a range of points that are inconsistent with his allegations:

- Mike Heil, whom Rose acknowledges made final decisions on Presario, supported Compaq's decision to remove the icons;
- Don Hardwick and others at Microsoft were informed of the plan to remove the icons in advance;
- No one from Microsoft indicated that removing the icons would violate a summer 1995 agreement.

Rose, 2/18/99am, at 37:16 - 42:1.

200.7.2. Mr. Rose's testimony concerning Compaq's removal of the Internet Explorer and MSN icons in 1996 is unreliable in other ways as well.

200.7.2.1. Mr. Rose was not personally involved in the removal of the Internet Explorer and MSN icons.

- i. Rose did not learn of the removal of the icons and the issue of a possible violation of an agreement with Microsoft until May 1996 -- months after their removal, and nine months after the alleged agreement with Microsoft and the known agreement with AOL that would have violated it. Rose, 2/17/99pm, at 64:8-18.
- ii. See also supra ¶ 200.7.



200.7.2.2. Mr. Rose repeatedly altered his testimony about events surrounding the removal and restoration of the Internet Explorer and MSN icons, and deliberately played word games in order to advance Microsoft's agenda.

- i. Mr. Rose either had not read his direct testimony or deliberately tried to obfuscate the proceedings by asserting Compaq did not "remove" the Internet Explorer and MSN icons.
  - Compare Rose Dir. ¶ 25 (Rose expressly stated that Compaq removed the Internet Explorer icon from Windows: "I understand that, in early 1996, Compaq did remove, on some consumer products, the Internet Explorer icon (as opposed to the Internet Explorer software) from the Windows 95 default desktop on its Presario line of personal computers").
  - With Rose, 2/18/99am, at 34:25 - 35:9 (Rose asserted that in fact Compaq did not remove the icons: "Compaq never removed the Internet Explorer or MSN icon from the desktop. What we did was we failed to comply with the OPK rules that we had agreed to. So we never put the icon for the Internet Explorer or MSN on--displayed on the Presario screen as an icon. So we didn't remove it. We just never put it up there."); Rose, 2/18/99am, at 51:7-15 ("A: It may be semantics, but that's - .Q: Your semantics. A: Yes, my semantics.").
- ii. Mr. Rose changed his testimony about the circumstances under which Compaq stopped shipping Netscape Navigator.
  - Compare Rose, 2/18/99am, at 65:12-25 ("Q: In 1996, did Compaq stop shipping Netscape Navigator with its PCs? A: I don't know specifically because there were some compatibility issues in that timeframe with Netscape Navigator in our overall system, so we went through an iterative process with Netscape on getting the compatibility

issues resolved. So, at that point in time, the Netscape Navigator may have been off, then back on. But the issue was compatibility. Q: When I asked you that question before, you said the issue was AOL. Do you remember that? A: You asked me a different question. The issue overall was AOL -- AOL's desire that we only feature AOL and GNN.").

- With Rose, 2/18/99am, at 62:20 - 64:6 (the earlier testimony, testifying that his understanding at that time was that Compaq would stop shipping Navigator on portable products not because Internet Explorer already filled the product category but because "at that time the issue was AOL, and AOL did not want us to feature any browser in there. . . .").

200.7.2.3. Mr. Rose's testimony is factually incorrect in important

respects.

- i. Rose's testimony that Compaq did not remove Internet Explorer from the Windows 95 Start menu is contradicted by contemporaneous documents. Rose Dir. ¶ 25. Compare GX 650 and DX 2265 (June 6, 1996 Hardwick letter to Dunn addressing need for Compaq to return Internet Explorer to its "original locations and functionality under the 'Start' button on Windows 95"); DX 2266 (June 26, 1996 Dunn letter to Microsoft on same topic).
- ii. Rose's testimony that Compaq merely removed, or did not install, the Internet Explorer and MSN icons and "replaced it with AOL and featured AOL, which had the Netscape Navigator in it" is incorrect. Rose, 2/17/99pm, at 69:4-10; Rose, 2/18/99am, at 48:24 - 49:10. Compaq in fact separately preinstalled Netscape Navigator, independently of AOL, as Rose himself recognized in his written testimony. Rose Dir. ¶ 26 (testifying Compaq featured Navigator on some models before Compaq's AOL agreement).

- iii. Rose's repeated testimony that GNN was AOL's "proprietary browser" is incorrect. Rose, 2/18/99am, at 63:20 - 64:6; Rose, 2/19/99am, at 35:1-7. GNN was an ISP offering distinct from AOL's flagship "AOL" service, which included (but was not limited to) a browser. As Compaq's agreement with AOL made clear, Compaq's obligation was to feature the AOL service and GNN, defined in the agreement as a "direct Internet service provider." DX 2261.

200.7.2.4. Mr. Rose's testimony that Compaq removed the Internet Explorer and MSN icons solely because of its contract with AOL) is inconsistent with contemporaneous documents prepared by Compaq executives -- Celeste Dunn and Stephen Decker -- who were involved in the Consumer Division's software decisionmaking. Rose Dir. ¶ 26; Rose, 2/18/99am, at 48:21 ("The issue here was AOL and the AOL browser").

- i. According to Decker, Compaq removed the Internet Explorer icon from the Compaq desktop because, "at the time, we had a relationship with Netscape and we had been shipping their product for a while. And, therefore, Netscape was actually the browser partner and we wanted to give [them] that position on the Compaq Presario desktop." Decker Dep. (read 2/18/99am), at 47:21-25.

201. In response to Microsoft's threat to terminate its license agreement, and in recognition of the fact that antagonizing Microsoft through dealings with Netscape or otherwise would jeopardize the favorable terms it enjoyed, Compaq reverted to a policy of not taking competitive actions that would invite Microsoft's retaliation.

201.1. Compaq agreed to distribute and promote Internet Explorer as its default browser on all desktop and server PCs in order to heal the conflict with Microsoft created by Compaq's internal use of Netscape products and to avoid further antagonizing Microsoft.

- i. In response to the email in which Dunn explained Microsoft was upset with Compaq's Netscape partnership and internal usage, a senior Compaq executive wrote to others within the company: "Please ensure that we can comply. Please work with Lori, Gene and Steve Flannigan as soon as possible to ensure success" in negotiating a palliative extension of the Compaq/Microsoft Frontline Partnership. GX 298.
- ii. Compaq extended its Frontline Partnership with Microsoft to the Internet/Intranet in a May 13th, 1996 agreement. Microsoft's cover letter made clear that the agreement included Compaq's "company-wide commitment to display the MSN icon on the desktop screen of all Windows 95 and Windows NT Workstation PCs and to ship Internet Explorer as the default Web browser on all desktop and server systems." The agreement also required Microsoft to ship new versions of Internet Explorer as the default browser on new Compaq products and to focus the "majority of Compaq's key Internet/Intranet announcements and marketing activities . . . on Microsoft's technologies and strategy." GX 1133.
- iii. At the time senior executives at Compaq signed the agreement, Dunn was concerned that its terms required Compaq's Consumer Division to "significantly alter the current Predator product, revise its business model, and jeopardize two profitable, revenue generating contracts" with AOL and Netscape. She also warned that the agreement conflicted with "our goal to feature the brand leader Netscape" and that it could raise Compaq's support costs, since "Both Netscape and AOL have agreed to provide end user support for their products and the On-line/Internet services. Traditionally Compaq has provided end user support for MS products and nothing in the MOU states differently. The cost of such support is estimated to be quite high." GX 299.
- iv. Compaq also entered into other agreements relating to distribution of Internet Explorer with Microsoft. GX 1130 (Amendment 1 to the September 10, 1996 agreement requiring Compaq to offer Internet Explorer as the preferred browser for listed Compaq Internet Products and to use two or more advanced features of Internet Explorer HTML extensions in Compaq's home page for each product); GX 1137 (July 1, 1996 agreement requiring Compaq to offer Internet Explorer as preferred browser for Support Software CD for desktop products); GX 1155 (sealed).
- v. Compaq executed an agreement under which Compaq promoted Internet Explorer exclusively. Decker Dep.,

2/18/99pm, at 15:3-12; GX 1155 (sealed). Rose acknowledged he had no reason to doubt Decker's testimony. Rose, 2/18/99pm, at 14:15 - 15:16.

201.2. Compaq complied with certain provisions of the "Windows Experience" screen and startup sequence restrictions

i.

GX 1023 (sealed). Despite that concern, Rose testified, Compaq executed an agreement in June 1996 to amend the Frontline Partnership to commit Compaq to "not replace or modify the OPK [OEM Preinstallation Kit] install process in any way." Rose Dir. ¶ 29; DX 2264.

ii. See also supra V.C.2.a.(1); ¶ 197.

201.3. In a further effort not to antagonize Microsoft and not to risk Microsoft's retaliation, Compaq decided not to preinstall Apple's QuickTime multimedia software.

i. Stephen Decker of Compaq told Phil Schiller of Apple that Compaq was reluctant to preinstall QuickTime for fear of upsetting Microsoft. Schiller Dep., 1/13/99, at 238:18 - 239:10.

ii. As a March 1998 e-mail from David Obelcz, who worked under Decker at Compaq, to Phil Schiller of Apple explained: "I wanted to thank you for your visit to Compaq and all the effort you have put in for QuickTime 3.0. I understand the path Compaq has taken and I know it was not the idea direction you had hoped for from the Consumer Division. . . . I think Apple has a lot to offer and I have been evangelizing QuickTime 3.0 and QuickTime 3.0 Pro as an excellent alternative to DirectShow for DVD title development. The folks in Redmond beat me up for it but also quietly tell me they are impressed. You have a great product Phil and I am sure we can find a home for it. . . ." GX 269.

201.4. Having experienced Microsoft's use of its monopoly power to secure the prominent positioning of Internet Explorer and MSN on the desktop of all Compaq PCs, Compaq recognizes

- i. An internal Compaq presentation on the "Microsoft Relationship" in January 1998 described
- ii. An August 12, 1997 review of the "Microsoft Partnership"

201.5. Compaq also supported Microsoft in this litigation, including by offering the testimony of John Rose, which was largely speculative and inconsistent with other evidence.

- i. Gates thanked Rose for his testimony, and Rose was not forthcoming about this discussion. Rose, 2/18/99pm, at 26:1- 31:14,

201.5.1. Little of Mr. Rose's testimony is based on personal knowledge about the issues it addresses.

- i. Rose acknowledged that he has not been involved in the Compaq's PC business for over two years. He testified, "The last time I had profit-and-loss accountability -- and I will use that as a measurement of accountability -- for the PC Products Group was June of 1996; and for the Consumer Products Group, it was in

September, actually August -- it ended in August, the beginning of September -- of 1995.” Rose, 2/17/99pm, at 10:12 - 11:4. Accordingly, he could not even “fathom a guess” about what Compaq’s support costs relating to Windows are. Rose, 2/18/99pm, at 44:25 - 45:24.

- ii. Rose has not been involved in the negotiation of Compaq’s license agreements with Microsoft, in contrast to others from Compaq who have testified about browser and operating system issues. Rose, 2/18/99pm at 18:23 - 22:13 (acknowledging Decker and Flannigan, but not Rose himself, negotiated Compaq’s current license with Microsoft).
- iii. Rose was not involved in any decisions about the removal of the MSN and Internet Explorer icons from the Windows desktop, and indeed did not learn of the removal for some time. Rose, 2/19/99am, at 62:19 - 64:12; Rose, 2/17/99pm, 64:8-18.

201.5.2. Mr. Rose’s testimony about demand for Windows and Internet

Explorer, and the benefits of their linkage, is uncorroborated and inconsistent with the documentary evidence.

- i. Rose’s written testimony that “Windows 98 has features and functions that our customers want and need” (Rose Dir. ¶ 16) is inconsistent with internal Compaq documents.
- ii. Rose conceded that he has no foundation for distinguishing between operating system and other (application) software, and has described both browsers and word processing software as “features” of personal computers generally. Rose Dep., 2/18/99pm, at 49:1 - 50:3.
- iii. Rose admitted he was unaware that the retail version of Windows 95 did not have a built-in browser. Rose, 2/18/99pm, at 53:4-7.

Given this ignorance, he could not meaningfully testify about why large businesses frequently choose, according to a 1998 Compaq research study, to replace the current version of Windows they buy with the retail version without a browser. GX 1242 at 7. Rose conceded that “about 80 percent of companies wipe or reformat the hard drives of new desktops. . . .The operating system (sic) reinstalled most often are OSR2 and the retail version of Windows 95. Large businesses lean more toward the retail version of Windows 95.” Rose, 2/18/99pm, at 51:13 - 52:9 (referring to GX 1242). He went on to testify, “I’m not sure why they would want the retail version of Windows 95.” Rose, 2/18/99pm, at 52:16-18.

202. In light of Compaq’s renewed commitment to support Microsoft’s Internet strategy and other accommodations, Microsoft has continued to bestow privileges on Compaq that were not granted to other OEMs.

202.1. Microsoft continued to

- i. See supra Part II.C.3; ¶ 38.
- ii.
- iii.
- iv.
- v.



202.2.

i.

202.3.

i.

ii.

iii.

Rose acknowledged that when Compaq signed the two MDAs, Compaq knew that the second agreement immediately superseded the first agreement; Rose agreed that, “when Government Exhibit 464 was signed, no one thought at that time that these were going to be the real terms. You knew you were executing at the very same time Exhibit 1438 that would supersede it.” Rose, 2/18/99pm, 61:25 - 62:12 (referring to Microsoft and Compaq terms);

iv. The special terms of the superseding MDA remain in force, at Compaq’s discretion, for the full two-year term of Compaq’s Windows license agreement, effective April 1, 1998. GX 1438 (sealed); GX 1190, at MS98 0008920 (sealed). The license itself acknowledges that Compaq has earned a discount for the year April 1998 through March 1999 and that, if Compaq exercises its right to extend the contract for another year, the MDA discount will also be effective for that year. GX 1190, at MS98 0008930 (sealed).

**(2) Microsoft used MDA discounts to induce other OEMs to take exclusionary actions**

203. Microsoft's Market Development Agreements ("MDAs") provide discounts off the Windows license fee to OEMs that undertake actions that benefit Microsoft in various ways.

- i. Norris of IBM testified that the MDA is "a vehicle that Microsoft used in order for us to perform activities that benefited them in many ways. It was a vehicle that also gave royalty reductions that imposed costs on the P.C. manufacturer in order to attain the royalty reductions." Norris, 6/7/99am, at 17:16-24. Norris also testified that it was within Microsoft's sole discretion whether or not an OEM was deemed to have "met" the MDA milestones and thereby earned the reduction against its Windows royalty. Norris, 6/7/99am, at 16:23 - 17:14.
- ii.

**(a) Microsoft offered discounts for making Internet Explorer the default browser**

203.1. Microsoft offered certain OEMs MDA discounts for making Internet Explorer the default browser on the PCs those OEMs shipped to their customers.

- i. See infra Part V.G; ¶ 297.4.3.2.
- ii.
- iii. Microsoft offered IBM a discount for making Internet Explorer the exclusive browser on IBM systems, but IBM refused it because it believed that IBM must maintain browser neutrality. See infra ¶¶ 205.1 - .3; Norris, 6/8/99am, at 30:2-14; GX 2203.

**(b) Microsoft offered discounts for preserving the Microsoft-dictated Windows interface**

203.2. Microsoft offered OEMs discounts for preserving the standard, Microsoft-dictated Windows desktop and boot-up sequence.

i.

GX 1503, at MSV 0003035 (IBM) (sealed); GX 1506, at MSV 0005932 (HP) (sealed); GX 1511, at MSV 0004213 (Packard Bell) (sealed); GX 1498, at GW 019843 (Gateway) (sealed); GX 1509, at MSV 0006946 (Hitachi) (sealed); GX 1493, at MSV 0006225 (AST) (sealed).

**(c) Microsoft offered discounts to OEMs that designed PCs in accordance with the Microsoft Hardware Design Guide (“HDG”) and subject to validation testing at Microsoft’s Windows Hardware Quality Labs (“WHQL”)**

203.3.

i.

ii.

iii.

iv.

203.3.1. Certification under the HDG is very competitively significant for OEMs.

i. Mr. Norris testified that customers check to see if Microsoft has certified that its systems meet Microsoft's standards; accordingly, he explained, IBM believes that it is competitively important to meet the WHQL requirement and get Microsoft's certification. Norris, 6/8/99am, at 9:4 - 10:4.

ii.

203.3.2. An OEM that wanted to offer a simplified or lower-cost PC to its customers would risk losing millions of dollars in price reductions for all its PCs if the lower-cost PC did not satisfy these MDA provisions.

i. Garry Norris testified that if IBM "wanted to offer any configuration of systems that were outside of the logo requirements or that may have been outside the requirements of the hardware design guide, then it placed at risk the opportunity for us to gain the royalty of \$2 in number 1 and \$2 in number 2 for all of the systems that we were shipping. And if you add that up. . . it's. . .

Roughly \$20 million in cost savings to IBM.” Norris, 6/8/99am, at 10:5-17.

ii.

203.3.3. As a result, OEMs generally satisfy HDG requirements. IBM, for example, complied with the HDG/WHQL milestones in its 1996 MDA because those milestones resulted in approximately \$20 million in discounts to IBM.

i. IBM complied with the WHQL requirements, and with the “next generation technology” requirement, in its MDA-96 because “\$20 million” -- the amount of the discount IBM could have lost if it did not comply -- “was a lot of cost savings in the business.” Norris, 6/8/99am, 10:18-23.

ii. In fact, Dean Schmalensee’s chart shows that

**b. Microsoft used its monopoly power to punish OEMs that refused to facilitate its exclusion of rivals**

204. Microsoft used its monopoly power to impose -- or threatened to impose -- penalties on OEMs that refused to aid its exclusionary strategy.

**(1) Microsoft threatened “MDA repercussions” if IBM continued to bundle Netscape**

205. In early 1997, Microsoft began trying to convince IBM to **promote and** distribute the upcoming release of its new browser, Internet Explorer 4.0.

205.1. At a March 6, 1997, meeting with IBM, representatives of Microsoft threatened that, if IBM did not pre-load and promote Internet Explorer 4.0 exclusively on its PCs (in other words, to the exclusion of Netscape Navigator), it would suffer “MDA repercussions.”

- i. Norris, 6/8/99am, at 29:11 - 32:5. Norris’ handwritten notes taken during that meeting record that Microsoft representatives told IBM “No Netscape and receive more MDA \$ across the PC Co.,” meaning that IBM would receive greater discounts against its Windows royalty rate, if IBM did not promote Netscape. GX 2164, at 80283. Microsoft also told IBM that it must “promote IE 4.0 exclusively -- if not MDA repercussions,” in other words, fewer discounts. GX 2164, at 80284.
- ii. Microsoft’s threat of “MDA repercussions” meant both that previously offered MDA dollars for exclusive Internet Explorer distribution would not be made available and that “the MDA we [IBM] currently had on the table, it was up to their [Microsoft’s] sole discretion as to whether we met them, and they may decide we didn’t meet them.”
- iii. Microsoft’s OEM account representative, Bengt Akerlind, made clear the meaning of Microsoft’s requirement that IBM distribute and promote Internet Explorer “exclusively:” “Bengt was very specific. He said, “No Netscape.” Norris, 6/8/99am, at 29:11-14. IBM “would not be able to load Netscape . . . . It would have to be Internet Explorer only.” Norris, 6/8/99am, at 30:2-14.
- iv. Akerlind also stated that in return for IBM shipping a so-called “neutral system,” by which Microsoft meant PCs with “IE 4.0, without any competitive software,” IBM not only would receive “soft dollars” but would also receive “new access to the Windows 95 and BackOffice source code,” and the ability to self-certify for Microsoft’s WHQL provisions, which would have helped the IBM PC Company avoid losing valuable time to market. Norris 6/8/99am, at 27:10 - 29:10; GX 2164 at 80283.

205.2. In a follow-up meeting with IBM on March 27, 1997, Microsoft representatives again insisted that IBM distribute and promote Internet Explorer exclusively and offered soft dollar marketing incentives and possible MDA reductions in return. In what Microsoft called a “private” or “secret” portion of this meeting, Microsoft’s Mr. Akerlind

specifically stated that “We have a problem if you load Netscape,” referring to the Navigator browser.

- i. Ted Hannum, Microsoft’s OEM account representative for IBM, told Norris in a March 21, 1997 telephone conversation planning the March 27 meeting that, following the main meeting, Microsoft wanted to have a “private meeting. Ted called secret discussions,” because Microsoft was “ready to put a proposal on the table for Internet Explorer.” GX 2166, at 80292; Norris, 6/8/99am, at 36:4 - 37:1.
- ii. During the “secret discussions” on March 27, Norris’ contemporaneous notes record that “After we exchanged niceties, the first thing Bengt said was, ‘we have a problem if you load Netscape,’ referring to Netscape’s Navigator. GX, 2168 at 80298; Norris, 6/8/99am, at 48:20 - 50:18. Norris, confirmed that this statement was the same as Akerlind had made in the previous meeting, and meant that “if we [IBM] were not willing to do some of the exclusive preloads that they were offering, that there would be MDA repercussions.” Norris, 6/8/99am, at 50:9-18.
- iii. Akerlind reiterated that by “neutral system” Microsoft meant the Internet Explorer 4.0 browser and other Microsoft software “would be installed on that neutral system and that there would be no competing software or applications installed.” GX 2168, at 80299; Norris 6/8/99am, at 47:11 - 48:9.
- iv. Norris’ planning memo for the March 27 meeting, based on his prior conversations with Hannum and Akerlind, corroborates that one of Microsoft’s objectives was “Demonstrate a prototype of I.E. 4.0 and gain IBM’s commitment to ‘exclusively’ and jointly promote I.E. 4.0 as the navigator [sic] of choice. In return Microsoft will offer IBM soft dollar marketing incentives,” and, Norris testified, “possible MDA reductions.” The memo also confirms that, “if IBM ‘neutralizes its desktops’ and other PCs, Microsoft would allow it to self certify Windows 95 for WHQL and get access to Windows 95 source code. GX 2167; Norris, 6/8/99am, at 41:1 - 44:23.
- v. See GX 2203 at 93800 (a March 12, 1997 email to the general manager of IBM’s Internet Division corroborating that “Last week Microsoft discussed the potential for IBM PC Co. to be part of the IE 4.0 launch and rollout. In order for us to be part of it, they want us to use IE 4.0 exclusively.”); Norris, 6/9/99pm, at 90:16 - 91:23.



205.3. IBM ultimately refused Microsoft's proposal that it exclusively ship Internet Explorer 4.0 and stop shipping Netscape because of the importance to IBM of maintaining browser neutrality.

- i. GX 2203, at 93798 (concluding that accepting Microsoft's proposal and shipping Internet Explorer 4.0 exclusively is unacceptable because "IBM has to maintain a browser neutral stance").

**(2) Microsoft threatened to harm Gateway if it supported or bundled Netscape**

206. Microsoft also told Gateway that its featuring of Netscape would harm its relationship with Microsoft.

- i. A Gateway employee reported that Microsoft's OEM account manager told Gateway that its use of Netscape on Gateway's corporate intranet was "a HUGE issue with MS" and that "MS wants to get back to doing co-marketing and sales campaigns with GW, but they won't if they see GW is anything but pro Microsoft." GX 308; GX 652 (Gateway CID response) (sealed); Von Holle Dep., 1/13/99, at 312:23 - 314:8.
- ii. The same Gateway employee also noted that "Dell turned Netscape down because they did not want to turn their relationship with Microsoft. Therefore, they get special things because of it." GX 308.

**(3) Microsoft repeatedly penalized IBM for competing against Microsoft**

207. In addition to penalizing OEMs that featured Netscape, Microsoft more generally discriminated against IBM for featuring competing products. These products included both IBM's OS/2 operating system, which competed against Windows, and various application programs. IBM's bundling of non-Microsoft applications deprived Microsoft of complementary revenues from the sale of its own applications -- a principal source of Microsoft's monopoly profits.

**(a) Microsoft withheld a Windows 95 license from IBM until 15 minutes before the product's launch because of IBM's preloading of competing products**

208. Microsoft delayed granting an essential Windows 95 license to IBM until 15 minutes before the product's launch because of IBM's preloading of competing products.

208.1. The IBM PC Company began negotiations with Microsoft for a Windows 95 license in approximately March 1995.

- i. Norris, 6/7/99am, at 24:5-14.
- ii. Garry Norris, who was Program Director for Software Strategy and Strategic Relations for the IBM PC Company from approximately March 1995 to April 1997, testified about his extensive first-hand experience as the IBM representative primarily responsible for leading IBM's Windows negotiations with Microsoft during this time. Norris, 6/7/99am, at 6:1-6; Norris, 6/7/99am, at 7:25 - 8:8. Norris personally served as the lead IBM negotiator for the Windows 95 license, negotiating with Microsoft's OEM account representative for IBM, Mark Baber, and with Joachim Kempin. Norris, 6/7/99am, at 24:15 - 25:1.

208.2. From March until approximately early June 1995, IBM's Windows 95 license negotiations with Microsoft proceeded relatively smoothly. Then, beginning in June, Microsoft slowed the pace of the license negotiations significantly.

- i. Norris, 6/7/99am, at 25:2 - 26:5
- ii. By contrast to the first two months of the negotiations, Microsoft suddenly stopped returning IBM's phone calls, and halted or seriously delayed returning to IBM marked-up drafts of license language to IBM. Norris, 6/7/99am, at 26:6-20.
- iii. Norris contemporaneously memorialized Microsoft's various delaying tactics in a July 19, 1995 e-mail to his superiors. Among other Microsoft actions, he recorded that "There has been very little progress over the last two weeks . . . ; MCSFT team has been non responsive; even on the smallest of items we have made no progress; no sense or urgency;

cancellation of meetings; not delivering faxes when promised; they have been acting on a part time basis and disjointed manner; taking days to get simple issues resolved . . . .” GX 2199; Norris, 6/7/99am, at 28:7 - 30:19; GX 2197.

208.3. Microsoft’s unresponsiveness and its actions to delay the Windows 95

license negotiations with IBM followed soon after IBM announced that it was seeking to acquire Lotus Development Corp., a direct competitor of Microsoft in messaging and office suite software, among other products.

- i. IBM announced on June 5, 1995 a hostile takeover attempt of Lotus. On June 11, IBM and Lotus reached an agreement for IBM to acquire Lotus. IBM completed the acquisition on approximately July 5, 1995. Norris, 6/7/99am, at 35:9 - 36:12.
- ii. Among other products, Lotus offered Lotus Notes, an e-mail product, and Lotus SmartSuite, an office productivity suite, that competed with Microsoft’s software. Norris, 6/7/99am, at 35:21 - 36:5.

208.4. Following IBM’s June 5, 1995, announcement but before Microsoft began

to slow the pace of the Windows 95 negotiations, Microsoft repeatedly questioned IBM representatives about IBM’s plans for Lotus’ products that competed with Microsoft’s products and expressed serious concern that such plans might place the two companies on a “collision course.”

- i. On several occasions after June 5, Mark Baber of Microsoft asked Mr. Norris “what are your plans for Lotus? What are IBM’s plans? Do you plan on pre-loading SmartSuite? Are you going to drop SmartSuite in the boxes of your PC systems? Exactly what do you plan on doing with SmartSuite?” Norris, 6/7/99am, at 36:13-25.
- ii. On June 27, 1995, Joachim Kempin met with IBM executive Tony Santelli and Roy Clauson. Santelli’s contemporaneous report of that meeting reflects that “Joachim expressed concern that our companies are headed on a collision course.” Among the specific issues raised by Mr. Kempin were: 2) Microsoft needs to better understand what’s behind the Lotus

deal. LVG [Louis V. Gerstner] should have called Gates to explain. 3) He [Kempin] heard rumors in South America (he just returned) that IBM was planning to preload 'Lotus Smart Suite' on all IBM PC's and sell it to 'OEM's for \$5/copy.'" Kempin felt strongly that a meeting between Gates and Gerstner was "crucial," and that one of the agenda items should be "Better understanding of IBM Lotus strategy." GX 2153; Norris, 6/7/99am, at 38:15 - 40:20.

- iii. The other IBM participant in the meeting confirms Mr. Santelli's report. A June 28, 1995, Clauson e-mail states that "Joachim thinks Lou and Bill need to talk, at times, as a professional courtesy, when significant events are about to take place." Kempin also stated that "MS is definitely worried about SmartSuite being given away and eating into their 'office heartland'" and that "There are lots of 'combative' people in MS ready to go to war with IBM." GX 2204.

208.5. On approximately July 17, 1995, after IBM's acquisition of Lotus, IBM announced that it was going to make Lotus SmartSuite "the primary desktop offering from IBM" in the United States.

- i. Norris, 6/7/99am, at 42:17 - 43:2.

208.6. On July 20, 1995, just three days after IBM's announcement that it would feature SmartSuite on its PCs, Microsoft informed IBM that it was cutting off altogether further Windows 95 negotiations with IBM. Microsoft's purported reason for halting negotiations was that it wanted first to resolve an ongoing, unrelated audit of IBM's past royalty payments.

Microsoft also cut off IBM's access to Windows 95 code that IBM needed for its PC product planning and development.

- i. Mark Baber of Microsoft called Norris on July 20 and told him that he had been instructed by senior Microsoft executives, specifically Bill Gates, Steve Ballmer, and Joachim Kempin, to halt further negotiations with IBM. Norris, 6/7/99am, at 30:20 - 31:6. This call came just three days after IBM's announcement of its plans for SmartSuite. Norris, 6/7/99am, at 43:3-8.

- ii. Microsoft “had cut off access to the code. Without the code, we couldn’t continue development of our products.” Norris, 6/7/99am, at 50:9-21.

208.6.1. Prior to this July 20 call, there had never been any connection or linkage between the ongoing audit and IBM’s negotiations for a Windows 95 license.

- i. “The audit was never linked to the Windows 95 license agreement in the past. We had never discussed the audit being a part of the Windows 95 license agreement. They had never mentioned that the audit was related to the Windows 95 license agreement.” Norris, 6/7/99am, at 32:4-18.
- ii. Because there had never been any connection between the two issues before July 20, Norris was “quite surprised” by Baber’s call telling him that Gates and others were now linking the two issues and halting all further negotiations. Before July 20, Norris, the lead negotiator for the Windows license, had no involvement “at all” in the audit. Norris, 6/7/99am, at 31:20 - 32:12.

208.6.2. The decision to halt all further Windows 95 license negotiations, ostensibly until the audit had been resolved, was made entirely by Microsoft. IBM strongly opposed any linkage that would impede its negotiation and receipt of a Windows 95 license and actively sought to resume negotiations as quickly as possible.

208.6.2.1. Contemporaneous documents confirm that it was Microsoft, not IBM, that linked the audit to the negotiations and used it as a pretext to cut off all further discussions in those negotiations.

- i. Even before Microsoft cut off the Windows 95 negotiations, IBM informed Microsoft that those negotiations were completely unrelated to the ongoing audit. In a July 18, 1995, letter concerning the audit, an IBM executive involved with the audit stated unequivocally that: “With respect to your comments about the signing of the Windows 95 license agreement, we consider the Windows 95 contract negotiations to be completely separate and unrelated to the audit and are actively

negotiating with Mark Baber to close a Windows 95 agreement as soon as possible.” GX 2371.

- ii. On July 20, 1995, the day IBM learned that Microsoft was halting further Windows license negotiations, IBM immediately protested in a letter from Rick Thoman to Bill Gates, which Norris helped write. IBM told Gates that IBM had been frustrated with the previous pace of negotiations but that “Today, Microsoft introduced a new issue, the pace of an existing contract audit, the settlement of which your team wants as a condition of finishing the contract and shipping product. This is a complete reversal of Microsoft’s prior position. There are no conditions under which this complex audit can be closed immediately.” GX 2197 (emphasis added); Norris, 6/7/99am, at 34:22 - 35:8; Norris, 6/7/99am, at 46:6-20 (because the several audits were being done consecutively, there was “no way” that the audit could have been completely resolved by the August 24, 1995, Windows 95 release date).
- iii. In a July 24, 1995, telephone conversation with Thoman, Bill Gates stated that it was the decision of “senior management” at Microsoft, specifically Gates and Mr. Ballmer, to cut off the Windows negotiations and link them to completion of the audit. Norris, 6/7/99am, at 45:7-11.
- iv. Thoman advised Kempin in an August 3, 1995, letter that “IBM is very serious about pursuing a Windows 95 license agreement. . . . I would hope IBM’s intent is clear. The PC Company has already stated publicly that it will ship and support Windows 95.” Thoman also told Kempin that IBM’s OS/2 group would continue to compete with Windows 95 but that the competition “should not be an issue on how you work together with the PC Company.” GX 2196; Norris, 6/7/99am, at 47:19 - 49:25.
- v. IBM made vigorous attempts to resolve the audit as quickly as possible so that negotiations for its Windows 95 license could resume. First, as an indication of its good faith, IBM offered a \$10 million prepayment to Microsoft to clear up any discrepancies that the audit might ultimately have revealed. Norris, 6/7/99am, at 45:12-21. Second, IBM

agreed that in any Windows 95 license agreement it would pay penalties and interest if any future audit disclosed underreporting by IBM. GX 2196; Norris, 6/7/99am, at 46:21 - 47:7; GX 2197 (IBM's Thoman told Gates on July 20 that the previous pace of the audit was due to the complexities of the issues and that "the auditors have told IBM that we have cooperated fully.").

- vi. Tony Santelli told Joachim Kempin in an August 21, 1995 letter that, given that all of the issues concerning the Windows 95 license were resolved, "I do not understand your reasons for continuing to link delivery of the Windows 95 code to resolution of the audit. . . . I think we should unlink the audit settlement from the Windows 95 code delivery." GX 2139.

208.6.2.2. Microsoft's attempts at trial to suggest that it was actually IBM, not Microsoft, that wanted to link the audit to the Windows license negotiations are erroneous and disingenuous.

- i. Microsoft questioned Norris about DX 2638, a July 14, 1995, letter from Nell Miller at Microsoft to James Miller at IBM concerning the audit. In that letter, Microsoft says that IBM's Miller had said that IBM might need to stop the audit and was "not sure you can sign the license for Windows 95 at this time." Norris, 6/9/99am, 54:21 - 55:16.
- ii. Microsoft did not introduce or mention, however, IBM's response, dated just four days later, in which the version of events Microsoft now advances is flatly rejected. On July 18, Jim Miller of IBM wrote back to Microsoft concerning the audit issues: "With respect to your comments about the signing of the Windows 95 license agreement, we consider the Windows 95 contract negotiations to be completely separate and unrelated to the audit and are actively negotiating with Mark Baber to close a Windows 95 agreement as soon as possible." GX 2371 (emphasis added).

### 208.6.3. Microsoft was willing to resume Windows 95 license

negotiations with IBM, by more readily resolving the audit dispute, on the condition that IBM would agree not to ship the competing SmartSuite product on its PCs for a minimum of six to twelve months. In fact, Joachim Kempin expressly told IBM executives that Microsoft would accept a lower payment to settle the audit if IBM agreed not to ship SmartSuite.

- i. On August 9, 1995, IBM's Santelli met with Kempin and Baber of Microsoft. Santelli's memo of the meeting, prepared just a few days later, records Kempin's statements. Kempin discussed a payment to settle the audit, and then "suggested this payment may be reduced through an offer of good faith from IBM . . . something he could show Gates. He suggested IBM not bundle Lotus SmartSuite on our systems for a minimum of six months to one year." GX 2195; Norris, 6/7/99am, at 51:9 - 54:13
- ii. Santelli also recorded in his memo Kempin's explanation for Microsoft attempting to keep IBM from shipping software products that competed with Microsoft's products. Santelli wrote that Kempin "is concerned on the impact to Microsoft profit from Office if they begin offering to OEM's as a preload. They view the 'threat of bundling' as a 'core issue' in the relationship." GX 2195. Norris confirmed that this is consistent with his understanding of the meeting at the time it occurred (Norris, 6/7/99am, at 53:17 - 54:13) and also consistent with the concerns Kempin had previously expressed about IBM possibly distributing SmartSuite with its PCs. Norris, 6/7/99am, at 54:24 - 55:17; GX 2204.
- iii. Kempin confirmed his August 9 proposal to help settle the audit if IBM agreed not to ship SmartSuite in a August 15 letter to Santelli. Kempin noted that Santelli had told him that IBM wanted to resolve the issues and complete its Windows 95 license quickly, but Kempin also warned that resolution of the audit "could lead to a delay in our ability to conclude the Windows 95 agreement." Kempin concluded by saying that "let me come back to one of my key points in our discussion. If you believe that the amount I am asking for is too much, I would be willing to trade certain relationship improving measures for the settlement charges and/or convert some of the amounts into marketing funds if IBM too agrees to promote Microsoft's software products together with



their hardware offerings.” GX 2138. Microsoft’s willingness to “trade certain relationship-improving measures” referred to trying to gain IBM’s commitment not to compete with Microsoft with SmartSuite. Norris, 6/7/99am, at 60:10 - 61:5.

208.7. Microsoft ultimately permitted IBM to sign a Windows 95 license agreement, but only 15 minutes before the official launch of Windows 95 occurred.

i. Norris, 6/7/99am, at 63:14-23.

**(b) Microsoft conditioned access to critical marketing support, and other terms and conditions for Windows provided to other OEMs, on IBM’s not preloading competing products with the PCs it shipped**

209. Microsoft also sought to induce IBM not to ship rival software by conditioning lower prices and other competitively important resources on IBM’s agreement not to ship software that competed with Microsoft products.

209.1. First, in late 1994, Microsoft attempted to induce IBM to reduce or eliminate competition from IBM’s rival operating system product, OS/2.

i. Norris testified that, in the second half of 1994, Microsoft proposed that IBM enter into a “Frontline Partnership” that would have required IBM to reduce or eliminate its shipments of OS/2, IBM’s operating system that competed with Windows. Norris, 6/7/99am, at 13:10 - 14:13.

209.1.1. IBM rejected Microsoft’s proposal to reduce operating system competition with it and decided, instead, to compete vigorously with Microsoft through OS/2.

i. Norris, 6/7/99am, at 13:24 - 14:13.

209.1.2. Microsoft penalized the IBM PC Company in several significant ways for its refusal to accept Microsoft’s proposal not to compete and its decision to continue its operating system competition.

- i. *First*, as a consequence of IBM's refusal to reduce its competition with Microsoft, Microsoft reduced from three to one the number of Microsoft OEM account managers that handled the IBM relationship. This reduced support adversely affected IBM's ability to test, manufacture, and ship its PCs to its customers. As a result, IBM lost time to market for its PC products. Norris, 6/7/99am, at 15:13 - 16:3.
- ii. *Second*, Microsoft informed IBM that it would treat IBM, not like other large OEMs such as Compaq, Dell and HP, but rather like any of the other hundreds of much smaller OEMs. Norris, 6/7/99am, at 14:14 - 15:9.
- iii. *Third*, IBM's beginning price for Windows 95 was \$75 per copy, a dramatic increase from the \$9 royalty IBM was then paying for Windows 3.1. Norris, 6/7/99am, at 20:1-12; GX 2132.

209.1.3. Microsoft's representatives expressly stated that it was penalizing IBM because IBM continued to compete with Microsoft.

- i. See infra ¶ 209.2.1.

209.2. Second, in the fall of 1995, Microsoft again advised IBM that it could have a "Frontline Partnership" with Microsoft if it reduced or eliminated its shipments of certain software products that competed with Microsoft's products.

209.2.1. Microsoft told IBM that, as long as the PC Company shipped competing software products on its PCs, IBM would get less attractive Windows prices, marketing support, access to Microsoft account representatives and technical personnel, and access to Microsoft enabling programs than if it did not ship competing products.

- i. Mark Baber told Norris that, because the IBM PC Company competed with Microsoft, IBM would not enjoy the benefits of the tier 1 OEMs, but rather would be treated like any other "tier 3" OEM. Norris, 6/7/99am, at 74:21 - 76:8.

- ii. IBM received this tier 3 treatment even though it was shipping approximately 4 to 5 million PCs during this time period. The royalties paid by the IBM PC Co. to Microsoft increased from approximately \$40 million in 1995 to \$220 million in 1996, to \$330 million in 1997, and to approximately \$440 million in 1998. Norris, 6/7/99am, at 76:14 - 77:5.
- iii. In a January 5, 1996, letter to Santelli, Microsoft's Joachim Kempin stated that "I firmly believe that the best solutions to customers around the world will get delivered by partners who closely cooperate and share common goals. As long as IBM is working first on their competitive offerings and prefers to fiercely compete with us in critical areas, we should just be honest with each other and admit that such priorities will not lead to a most exciting relationship and might not even make IBM feel good when selling solutions based on Microsoft's products." Kempin added: "You are a valued OEM customer of Microsoft, with whom we will cooperate as much as your self-imposed restraints allow us to do." GX 2142; Norris, 6/7/99am, at 82:15 - 83:24.

209.2.2. The IBM PC Company was denied access to Microsoft's so-called "enabling programs," in which IBM's competitors such as Compaq, HP, and DEC participated, because it continued to ship products that competed with Microsoft's.

- i. Surveys conducted by Norris indicated that Microsoft's refusal to allow IBM to participate in the "enabling programs" cost IBM over \$180 million because it resulted in "customer perception that IBM lacked a good relationship with Microsoft." Norris, 6/7/99pm, at 30:1-6. In spite of persistent attempts to gain access to these "very important" programs the IBM PC Company was not permitted by Microsoft to participate. Norris, 6/8/99am, at 44:6 - 45:14.
- ii. These enabling programs included the Microsoft Authorized Support Center, the Microsoft Certified Solution Provider Program, and the Authorized Technical Education Center Program. Norris, 6/7/99am, at 77:6 - 78:14.
- iii. Microsoft blocked IBM's participation in the "enabling programs" despite the benefit to Windows users of IBM's participation. Norris, 6/7/99pm, at 36:9-15.

209.2.3. Microsoft's Mr. Gates and Mr. Kempin discussed as early as March 1994 using Microsoft's global relationship with IBM and its OEM relationship to apply pressure to IBM not to deal with Lotus.

- i. In a March 20, 1994, e-mail, Gates wrote to Kempin: "This is one topic I really want to try to get to the bottom of. Why does IBM help Lotus so much? Is there anything we can do about this? Should it become an issue in our global relationship with IBM?" Kempin's response acknowledges that Microsoft has mentioned the Lotus situation "as an issue" in recent "partnership" talks with IBM, and later states that "I am unsure if we need to see this as an organizational issue or an OEM issue. I am willing to do whatever it takes to kick them out, but strongly believe we need a worldwide hit team to attack IBM as a large account, whereby the OEM relationship should be used to apply some pressure. GX 328 (emphasis added).

209.3. Third, Microsoft used similar tactics in 1996 and 1997 in a further effort to convince IBM not to ship the competing Lotus SmartSuite and Notes products.

- i. In a January 31, 1996, call with Santelli, Joachim Kempin "opened the discussion expressing a strong concern about IBM PC Company bundling Lotus SmartSuite. He has two issues; first, why didn't Microsoft get a chance to compete, and second, it makes our attempt to improve our relationship more difficult because when PCCO wins, Lotus wins & Microsoft loses." GX 2157; Norris, 6/7/99am, at 85:4 - 86:5. Kempin's concern represented "no change in the theme. As long as we are competing, the relationship was going to be difficult." Norris, 6/7/99am, at 86:6-12.
- ii. In a February 19, 1997, meeting with IBM, Bengt Akerlind stated that Bill Gates was "really upset" that the IBM PC company continued to compete with Microsoft by shipping SmartSuite and Notes. Gates asked "Why are we working with IBM when they are doing these deals? Don't work with them!" GX 2163, at 80278. Norris 6/8/99am, at 19:22 - 20:25. Akerlind asked IBM "How religious is our support of SmartSuite," GX 2163, at 80278 (referring to IBM's support of SmartSuite), meaning "what would it take to get you to not load SmartSuite?" Norris, 6/8/99am, at 21:1-11.

- iii. Similarly, in March 1997, Microsoft representatives conditioned IBM's access to Windows 95 source code and permission for it to self-certify its compliance with Microsoft's WHQL requirements, both of which were of considerable value to IBM (see supra ¶ 203.3.3), on IBM's agreement to remove SmartSuite, Notes, and Netscape from its PCs and ship Microsoft's software applications. See supra ¶¶ 198.1.iv; 198.2.iii & iv; GX 2164, at 80284 (Norris notes of March 6 meeting: "Bengt: SmartSuite, WorldBook, Notes. Remove objectionable apps and make the systmes neutral."); Norris, 6/8/99am, at 32:19 - 33:10 (Microsoft "wanted us to stop loading those applications, remove them, and start loading Microsoft applications. Neutral.").
- iv. Mark Baber of Microsoft told Norris expressly in the April to June 1996 timeframe that Kempin would not meet with Santelli of IBM to discuss Windows royalties or improving the IBM-Microsoft relationship because IBM was distributing Lotus SmartSuite with its PCs. GX 2183, at 90451; Norris, 6/7/99pm, at 19:11 - 20:18.
- v. Microsoft's Kempin also told IBM representatives that Microsoft would not provide quotations for IBM to use in press releases for its PCs in cases where IBM was bundling SmartSuite on its machines or placing it in the box. GX 2193; Norris, 6/7/99pm, at 24:9 - 27:10.

209.4. Microsoft also threatened to withhold public endorsements for and statements of cooperation with IBM because of the IBM PC Company's decision to ship World Book, an electronic encyclopedia, with its PCs rather than shipping Microsoft's competing encyclopedia, Encarta.

- i. GX 2158 (e-mail reporting that at a January 30, 1997 meeting, Microsoft's IBM account representative reported that Mr. Gates "was really mad about the World Book deal, given that IBM wants a close relationship in this market with them."); Norris, 6/8/99am, at 11:4 - 15:24.
- ii. Akerlind reported in the February 19 meeting that Gates wanted to know why the Microsoft OEM team was continuing to work with IBM in light of the fact that IBM was offering SmartSuite, Notes, and WorldBook. GX 2163, at 80278.

**(c) Microsoft sought to condition substantial MDA price reductions on IBM's ceasing to support competing products**

210. Microsoft also sought to condition substantial MDA price discounts on IBM's ceasing to ship with its PCs products that competed with Microsoft's products.

210.1. Microsoft proposed that at least \$8, out of the total possible MDA discount of \$27 applicable to IBM's Windows 95 operating system license, be conditioned on IBM's reducing or eliminating its shipments of and support for its competing OS/2 operating system. Given the total number of IBM's PC shipments at the time, Microsoft was in effect offering IBM roughly \$40-48 million in Windows price reductions if it would reduce or eliminate its OS/2 competition.

- i. The proposed 1995 MDA, sent by Microsoft to IBM on October 21, 1994, contained among other "milestone" activities the following: "Adopt Windows 95 as the standard operating system for IBM (\$3.00); "Windows 95 is the only OS mentioned in advertisement" (2 milestones for total of \$2.00); and shipping Windows 95 preinstalled on at least 50% of IBM PCs within two months after the release of Windows 95 (\$3.00). GX 2132; Norris, 6/7/99am, at 20:23 - 22:9.
- ii. An \$8 royalty reduction per PC shipped, multiplied across the 5-6 million PCs IBM was shipping at this point, would have totaled approximately \$40-48 million per year. Norris, 6/7/99am, at 21:20 - 22:1; Norris, 6/7/99am, at 22:12-18.

210.2. Microsoft's proposed Windows Desktop Family agreement, presented to IBM in early 1996, conditioned IBM's receipt of future Windows 95 MDA discounts on IBM's agreeing to a substantial increase in its royalty rate for Windows 3.1, the distribution of which Microsoft sought to discourage.

- i. Norris, 6/7/99pm, at 11:1 - 13:12.

- ii. See also supra Part II.C.2.b; ¶ 37.1.

210.3. In meetings in early 1997, Microsoft expressly conditioned additional MDA dollars on IBM's agreeing to distribute and promote Internet Explorer exclusively and not to distribute or promote Netscape Navigator and other competing software on IBM PCs.

- i. As recorded in Norris' contemporaneous notes of the meeting, Akerlind told IBM that it "would not be able to load Netscape on that system. It would have to be Internet Explorer only. And if we did, we would receive more MDA dollars, not just on consumer systems, but also on ThinkPad systems and also on desktop systems. So every system that we shipped from the P.C. Company." IBM also would receive "soft dollars" and payments for joint marketing events. GX 2164, at 80283; Norris, 6/8/99am, 28:22 - 31:23. The quid pro quo Akerlind described, and that Norris recorded in his notes, was clear: "No Netscape and receive more MDA dollars across the P.C. Company." GX 2164, at 80283; Norris, 6/8/99am, 28:22 - 31:23.

**c. Microsoft's anticompetitive intent is evidenced by the clear contrast in its treatment of IBM and Compaq**

211. The anticompetitive character of Microsoft's conduct is confirmed by the fact that Microsoft makes clear it favors OEMs that support its exclusionary strategies, such as Compaq, and penalizes OEMs, such as IBM and Gateway, that refuse.

211.1. Microsoft representatives told IBM that its adverse treatment was the result of IBM's competing with Microsoft and that IBM could have the same deal as Compaq if it stopped competing with Microsoft.

- i. Norris was told directly by Microsoft representatives that "as long as you're competing with Microsoft, you will suffer in the market in terms of prices, terms and conditions, marketing support programs, and technical support programs." He also was told on several specific occasions that "IBM can have Compaq's deal when it quits competing." Norris, 6/7/99am, at 16:4-15; Norris, 6/7/99am, at 74:9-20.

- ii. Norris reported to his superiors that Microsoft had told him directly ““as long as you’re competing with Microsoft, you’re going to have difficulties in this relationship.”” Norris, 6/7/99am, at 48:25 - 49:25.
- iii. During negotiations about the Windows Desktop Family agreement in early 1996, Mark Baber of Microsoft told Norris that “MS would match Compaq if we made the same commitment that Compaq did.” GX 2180, at 13371. Microsoft representatives explained to Norris that, “when IBM stops competing with Microsoft, then we can have Compaq’s deal: prices, terms and conditions.” This meant that IBM needed to cease shipping the competitive offerings that it loaded on its PCs, in particular SmartSuite and, previously, OS/2. Norris, 6/7/99pm, at 17:6 - 18:20.

211.2. Despite its representation that it treats all OEMs equally, Microsoft in fact plainly favors Compaq and cooperating OEMs and penalizes OEMs, such as IBM, that refuse to assist Microsoft in its exclusion of its rivals.

- i. Although Microsoft told OEMs that “all OEM’s of Windows 95 are treated equally by” Microsoft “in meeting the same OPK requirements for shipping Windows 95 PC’s to ensure the customer of a consistent experience” (GX 294), in practice Microsoft favored Compaq by permitting it to customize the start-up sequence in Windows 95 in ways it denied to other OEMs (Romano Dep. (played 12/16/98pm), at 52:10 - 54:6) and by permitting it to include its own ISP sign-up process before other OEMs were allowed to do so. Kempin, 2/24/99pm, at 42:22 - 43:9.
- ii. GX 433, a 1993 Compaq “Microsoft Meeting Preparation” document, includes slide 8 entitled “Judgment: How retaliatory would they get?” (sealed; cited portion published). Compaq’s John Rose testified that he expected that this slide referred to possible retaliation by Microsoft. Rose 2/18/99am, at 22:6-9. In contrast to Compaq, which ultimately received favorable treatment on such items from Microsoft as a consequence of not competing, the IBM PC Company suffered precisely the sort of retaliation listed in GX 433 because it continued to ship with its PCs software that competed with Microsoft’s, including Netscape Navigator and OS/2. Norris 6/8/99am, at 53:5 - 57:21.
- iii. In an October 30, 1997 e-mail, Bill Gates observed that IBM “continue[s] to use their PCs to distribute things against us.” He then flatly states that “Overall, we will never have the same relationship with IBM that we have with Compaq, Dell and even HP, because of their software ambitions.”



GX 257. Mr. Gates' statement of the consequences to IBM of its "software ambitions" is "very consistent" with the treatment IBM received from Microsoft. Norris 6/8/99am, at 58:14 - 60:4.

- iv. See supra Part II.C.3; ¶ 38 (Microsoft's price discrimination favors OEMs who assist Microsoft's exclusionary strategy).
- v. Cf. GX 2290 (October 23, 1997 internal Microsoft e-mail that identifies particular software companies as "friend," "enemy," or "neutral," and determined the level of support Microsoft would provided based on those characterizations).