G. Microsoft set a predatory price for Internet Explorer

295. Microsoft set a "better than free" price for Internet Explorer for the specific purpose, and with the effect, of weakening browser rivals and thereby maintaining its operating system monopoly.

1. Microsoft set a zero price for its browser for the purpose of depriving Netscape of revenue and protecting its operating system monopoly

296. Microsoft recognized before the release of Windows 95 (and continued to recognize before the release of Windows 98) that charging for Internet Explorer would generate additional revenue and contemplated charging OEMs and others for it as part of a software add-on product called, before Windows 95's release, "Frosting."

i. In January 1995, Microsoft concluded that "frosting without Ohare represents a $63MM opportunity, and with Ohare a $120MM opportunity. We're talking about $57MM difference. It appears that as many as 1.5MM frosting customers will buy it for the internet access." GX 142.

ii. A February 10, 1995 Microsoft memorandum entitled "The Case for Shipping O'Hare with Frosting" evaluates four possible packaging alternatives (none of which are to bundle O'Hare with Windows 95) for the first version of Internet Explorer, and recommends that O'Hare should be put in the Windows 95 add-on product called Frosting to "scoop incremental revenue from the frosting product." The memo cites a study conducted in January 1995 by Microsoft that "shows that we can nearly double frosting sales by including O'Hare in the Frosting pack. . . . This increases Frosting year 1 sales from an estimated $81 MM to $151 MM, with marginal incremental COGS, and incremental profits of $61 MM." GX 606.

iii. See GX 140, at MS98 0107151 (1/13/95 Slivka report noting that shipping O'Hare with the release of Windows 95 "Helps sell more units of Win95 Frosting (assuming O'Hare is not in Win95)"); GX 143 (Microsoft document commenting: "We shouldn't give our stuff away."); GX 63 (7/95 Jones e-mail recommending regarding Internet Explorer that Microsoft should "Figure out pricing and promote agressively [sic]. We need someone who will go and sell this thing . . . ."); GX 114 (Chase notes that a "pro" of a proposal to charge for aspects of Internet Explorer is that it "starts people getting to think about everything won't be free"; a "con" is that it would "hurt IE share efforts"); GX 118, at MS7 005732 (Windows marketing group reported research that, upon “hearing IE 4 is free” the price users were willing to pay for the Windows 98 upgrade product dropped from $100 to “$10 to $30”).

297. Microsoft nonetheless chose not to charge for the browser, and to continue not to charge for the browser.

297.1. Microsoft included Internet Explorer in Windows at no separate or extra charge.

i. On July 3, 1995, Microsoft released its “Microsoft Internet Jumpstart Kit” to OEMs “at no additional charge.” GX 36.

ii. Dean Schmalensee conceded that he is unaware of any circumstances in which Microsoft has charged for Internet Explorer, either as part of the operating system or as a separate application. Schmalensee, 1/20/99am, at 21:10-18.

iii. Microsoft’s Brad Silverberg is unaware that Microsoft ever identified or allocated a portion of the price of Windows to Internet Explorer. Silverberg Dep., 1/13/99, at 685:25 - 686:5.

297.2. Microsoft also licensed Internet Explorer at a zero price and committed to doing so “forever” when it distributes Internet Explorer separately from Windows.

i. Bill Gates announced on December 7, 1995, that Microsoft would make the “Internet add-on” “available at no cost.” GX 502, at MS98 0116232; Silverberg Dep., 1/13/99, at 686:6-14 (same).

ii. Dr. Warren-Boulton testified: “Microsoft’s decision to give IE away free to the installed base of Windows users meant sacrificing substantial revenue from two sources. First, Microsoft lost revenue from not licensing IE at a positive price as a stand-alone application -- whether through downloads directly to end users or through positive licence fees to ISPs, OLSs and ICPs. Second, Microsoft lost revenue from retail sales of Windows 98 upgrades because providing IE free to the installed base reduced the demand for the Windows 98 upgrade and the revenue Microsoft earns from that source.” Warren-Boulton Dir. ¶ 190.

298. Microsoft chose to give Internet Explorer away for free for the purpose of blunting the threat Netscape posed to Microsoft's operating system monopoly.

i. Professor Fisher concluded that "Microsoft studied Netscape's business model and studied its source of revenue. Microsoft priced its browser for free and bundled its browser and put a lot of effort into . . . promoting, bribing, and forcing people to take its browser. A good deal of that appears to me and appears, I think, from Microsoft documents, to have been directed at thwarting the threat that Netscape represented to the operating system monopoly." Fisher, 1/7/99am, 75:19 - 76:1.

ii. In July 1997, Microsoft's Moshie Dunie noted that selling the Windows 98 "shell" and browser separately "would certainly increase significantly Win98 upgrade sales." GX 113. Dunie continued that, although "there is the browser share counter argument" increasing upgrade revenue was "an intriguing thought." GX 731. Paul Maritz responded: "It is tempting, but we have to remember that getting browser share up to 50% (or more) is still the major goal." GX 731; GX 514 (same document). Maritz conceded at trial that he thought the proposal "to take some features out of Internet Explorer 4.0 and charge for them separately" was "a proposal with merit, but that it was outweighed by the desire to increase browser share." Maritz, 1/26/99pm, at 25:17 - 27:16, 27:18 - 29:8.

298.1. Microsoft determined to give Internet Explorer away for free to "cut off Netscape's air supply."

i. Steven McGeady of Intel testified that Paul Maritz told Intel representatives in a meeting in the fall of 1995 that Microsoft planned to "cut off Netscape's air supply" by giving the browser away for free so that Netscape could not invest in it. McGeady, 11/9/98pm, at 53:8 - 55:16; McGeady, 11/12/98am, at 73:21 - 76:4 (same). A January 1998 New York Times article also quoted McGeady as reporting that Microsoft representatives told him: "we are going to cut off their air supply. Everything they're selling, we're going to give away for free." GX 1640, at 4.

ii. Russell Barck of Intel testified that Maritz "said the term 'embrace and smother' with respect to a strategy with respect to Netscape." Maritz, 1/26/99am, at 55:19 - 57:1 (quoting Barck's deposition); Rob Sullivan (a person for whose competence and integrity Maritz has a high regard) also testified that Maritz said the phrase "embrace and smother," and that he "understood that concept to mean that Microsoft intended to deprive Netscape of revenue and viability." He understood that Microsoft would achieve this "by giving away their products, by embracing the Internet standards and extending them in a way that favored the Windows platform." Maritz, 1/26/99am, at 57:2 - 59:8 (quoting Sullivan's deposition).

298.2. Beginning in 1995, as part of its plan to "cut off Netscape's air supply" and for the purpose of determining how to deprive Netscape of revenue necessary to compete effectively, Microsoft studied Netscape's sources of revenue.

i. Microsoft was aware that Netscape made most of its revenues from browser sales. Paul Maritz's February 1996 memorandum "Internet Browsers" includes a graph showing more than half of Netscape's "Revenue Mix" comes from its "clients." The same document lists "More $'s even than Netscape" as one of Microsoft's strengths. GX 473, at MS6 6006240; MS6 6006256.

ii. In the same April 1996 memorandum in which he argued the importance of maximizing browser share even though Internet Explorer is a "no revenue product," Brad Chase described "own corporate browser licensing" as "one of the biggest potential revenue opportunities for Netscape." GX 39, at MS6 5005720. Professor Fisher testified that the juxtaposition of these statements suggests that "Microsoft was interested in, quote, winning the browser battle, unquote, not because of the revenues it would bring in directly, but because of the effect that would have in protecting Microsoft's operating-system monopoly." Fisher, 1/12/99am, 40:16 - 41:16.

iii. Steve Ballmer asked his staff in August 1996 to do a "drill-down on Netscape's browser revenues to understand where they make money." Bengt Akerlind responded that "Netscape can no longer make any money on the browser in the OEM market." He also noted that "Customers/ISPs don't want to talk" about their payments to Netscape because "they all know we are out to get them." GX 343. Cameron Myhrvold testified that he understood "them" in that sentence to refer to Netscape. Myhrvold, 2/10/99pm, 26:3-15.

iv. In an August 1996 e-mail entitled "Netscape Browser Breakdown," Amar Nehru wrote to Cameron Myhrvold, Joachim Kempin, and others: "Stevenb asked us to coordinate a drill-down on Netscape's <u>browser</u> revenues to understand where they make money and get back to him in 2 weeks. He suggested I contact all of you. I'd be grateful if your organizations could help us get data to answer this question. In the latest quarter ended June 30, 1996 (Q2-96), Netscape browser revenues were $45mm worldwide. For FY 1997

(Jan 1 - Dec 31), Netscape's browser revenue is projected at $270mm worldwide. Net, we are trying to categorize the $45mm and $270mm figures by channel and sub-channel to see how this can pencil out." GX 969 (emphases in original).

v. In November 1996, Amar Nehru sent an e-mail to the Executive Staff with a long report on "Netscape Revenues." The e-mail provides in-depth analyses of Netscape's product revenues, including revenues from browsers. "Browser revenue for the quarter [Q2-1996] amounted to $45 million (a 32% increase over the last quarter) representing 60% of total Netscape revenue. Of the $45 million, ISP's commanded the largest share at 40% of browser revenue, with direct sales to LORGs via site licenses coming in second at 28% share." GX 100, at MS98 0122161.

vi. See GX 39, at MS6 5005720 (Chase emphasized that Netscape's survival depends on their ability to upgrade a significant chunk of their installed base to Communicator. They also count on it as a significant source of revenue and wrote: "Own Corporate browser licensing. This is one of the biggest potential revenue opportunities for Netscape. As soon as we have Win 3.1 and Mac clients, we should have absolute dominant browser share in the corporate space."); GX 424

(sealed).

vii. Professor Fisher concluded that "Microsoft, at Bill Gates' personal direction, undertook detailed studies of Netscape's sources of revenue and what Netscape required to survive as an effective competitor. At the time Microsoft made the decision to supply IE without charge, Microsoft estimated that at the time Microsoft made its decision to supply IE without charge, from 20 percent to 50 percent of Netscape's revenues came from licensing its browser. (Bill Gates 8/27/98 Dep. Tr. 236.) Microsoft's decision to price its browser below cost (indeed, at a zero or even negative price) was thus made when it knew that Netscape was charging for its browser and that Netscape depended on those revenues to continue to compete effectively." Fisher Dir. ¶ 125.

298.3. Netscape originally charged for its browser and, absent Microsoft's decision to give its browser away "forever free," would have continued to do so.

298.3.1. Netscape charged for its browser before Microsoft launched its predatory campaign.

i. James Barksdale testified: "The commercial release of Netscape Navigator 1.0 occurred on December 15, 1994. By the end of the second quarter of 1995, Netscape had collected over $10 million in revenue generated by the browser alone. By the end of 1995, Netscape had collected approximately $45 million in revenue from browsers." Barksdale Dir. ¶ 18, 57.

ii. Barksdale confirmed that: "Although Netscape distributed the beta (i.e. pre-release) version of Netscape Navigator 1.0 free on the Internet, Netscape's business model in the early days reflected our intention to charge customers to use the browser. Consistent with this intent, soon after Netscape rolled out its retail release on December 15, 1994, Netscape made it clear to the world that Netscape would charge for Navigator. The initial price for a Navigator license was $39." Barksdale Dir. ¶ 20.

iii. Cameron Myhrvold testified that, in the summer of 1995, Navigator Personal Edition was priced at $39. Myhrvold Dir. ¶ 22.

iv. Dean Schmalensee conceded that Netscape sold Navigator at a positive price. Schmalensee, 6/21/99am, at 13:9 - 15:9.

298.3.2. Netscape dropped the price of its browser to zero only in response to Microsoft's predatory strategy.

i. Dr. Warren-Boulton testified that, because the "incentives" to earn sales on complementary products "were present when Netscape first decided to charge a positive price for its browser." It "was not the potential for the generation of ancillary revenue that brought the market price of the browser down the zero, but rather Microsoft's actions." Warren-Boulton Dir. ¶ 192.

ii. Barksdale testified that Microsoft's pricing policy forced Netscape to also give away its browser. "On the revenue side, all our browser revenue disappeared because it became increasingly difficult to charge for a product that our principle competitor was offering for free or 'better than free.'" Barksdale Dir. ¶ 225. He later testified that Netscape made the browser for free because it was "forced to" by Microsoft's pricing policies: "There was no alternative." Barksdale, 10/27/98pm, at 13:14-20.

298.3.3. Microsoft's contention that its zero price simply mirrored Netscape's "free but not free" strategy is wrong.

i. During cross examination, Barksdale rejected the suggestion that Netscape's pricing strategy was "free but not free," Barksdale, 10/21/98pm, at 43:8-19. He testified: "to have no revenue and just market share, I didn't consider that then, now or ever, to be a viable business strategy." Barksdale, 10/21/98pm, at 47:19 - 48:1.

ii. James Clark, founder of Netscape, testified: "Netscape has never given away the browser. It allowed people to download it for free for one brief period during the beta; but after that, it never gave it away." Clark Dep. (played 10/27/98pm), at 18:2-5. Marc Andreessen affirmed that Netscape believed early that it would give away browsers to education and nonprofit users, but planned to charge all others: "In fact, that was fundamental to the company's business plan." Those plans did not change until January 1998, when MS's pricing rendered the browser market "noneconomic." Andreessen Dep. (played 10/27/98pm), at 14:11 - 16:25.

iii. Dan Rosen, of Microsoft, was aware that Netscape was selling "site licenses" to enterprises for browsers in June 1995. GX 25 (Rosen's notes reflecting June 2, 1995 meeting with Netscape).

iv. Cameron Myhrvold testified that Netscape was losing sales to ISPs in competition with Microsoft precisely because Microsoft gave away Internet Explorer while Netscape charged for the browser. Myhrvold Dir. ¶¶ 109-111.

v. Dean Schmalensee acknowledged that Netscape always charged corporate users for its Navigator browser. Schmalensee Dir. ¶ 273. "Netscape had to lower its prices (or charge fewer customers) in response to IE 3." Schmalensee Dir. ¶ 279. He further recognized: "The release of IE 4 put even more pressure on Netscape's ability to charge for Web browsing software." Schmalensee Dir. ¶ 280.

298.4. Microsoft published statements about Netscape's precarious financial position in order to increase the damage to Netscape from the revenue loss resulting from Internet Explorer's zero price.

i. In an October 1995 Q&A for the New York Times, Bill Gates described Netscape's high stock market valuation as a "challenge" for the company. "Netscape has little income, but investors have valued its stock at more than $2 billion. When a company's shares have a high value, expectations from investors, including employee-owners, are correspondingly high. Failure to meet those expectations can be damaging." GX 333.

ii. A July 1996 Business Week article, entitled "Netscape: Sitting Pretty -- Or Sitting Duck?," concluded "Netscape, publicly, is unfazed . . . but Microsoft, a global software empire with expected fiscal 1996 sales of $8.6 billion and $2 billion in aftertax profits, has one enduring edge. 'One thing to remember about Microsoft,' says Chairman William H. Gates III. 'We don't need to make any revenue from Internet software.' Who could forget?" GX 84.

iii. A July 1996 Infoworld report stated that Bill Gates, in comments to reporters, made a point to "position Netscape as a 'middleware' company. He then reminded the assembled press critters that, historically, middleware companies do not last long. Any lead Netscape has, Microsoft hopes to erase in the home stretch, or -- to quote [Gates] -- 'What part of the fact that Microsoft owns Windows don't you understand?'" GX 1248; Barksdale Dir. ¶ 120.

iv. A January 1997 Forbes article quotes Steve Ballmer as saying, "We're giving away a pretty good browser as part of the operating system. How long can they survive selling it?" GX 103, at p.2.

v. Bill Gates anticipated the impact of such statements in a memo to his senior executive staff in May 1996: "At some point financial minded analysts will begin to consider how much of a revenue stream Netscape will be able to generate." GX 41, at MS6 6012956.

vi. Mr. Barksdale confirmed: "Given the power that Microsoft, and in particular, Mr. Gates, has in influencing the computer industry and analysts, Microsoft's negative comments, as intended, directly affected Netscape's ability to compete effectively. It was not a totally uncommon event for a customer to question whether it made sense to do business with Netscape because of Microsoft's public position that it was going to crush Netscape's business." Barksdale Dir. ¶ 115.

298.5. Microsoft witnesses' assertions that its pricing of Internet Explorer was not intended to harm Netscape to the contrary are not credible.

298.5.1. Mr. Gates' testimony that Microsoft's inclusion of Internet Explorer in Windows at no separate charge had nothing to do with Netscape (Gates Dep., 1/13/99, at 478:7 - 480:4) is not credible.

i. In June 1996, Gates reportedly said to the Financial Times: "Our business model works even if all Internet software is free. We are still selling operating systems. What does Netscape's business model look like (if that happens)? Not very good." GX 71. McGeady testified this statement is consistent with what Maritz said in his presence. McGeady, 11/12/98pm, 42:4-16; Barksdale Dir. ¶ 119.

ii. Microsoft held a briefing for press and analysts on the first anniversary of Bill Gates' 1995 "Pearl Harbor Day" speech, and announced that Microsoft would give away Internet Explorer and then include it in its operating systems. Mr. Barksdale testified that the Seattle Times "reported that during the briefing Microsoft executives Greg Maffei and Paul Maritz gloated over the $30 drop in Netscape's stock price that resulted from the Gates announcement, and reported that another of their colleagues said of the precipitous drop in the stock price, 'That's not enough.'" Barksdale Dir. ¶ 117; GX 1570.

298.5.2. Mr. Gates' testimony that he did not know whether Microsoft employees collected information concerning Netscape's revenues (Gates Dep., 1/13/99, at 359:14 - 456:16, 385:13 - 486:25) is not credible.

i. Gates in July 1996 responded to an outline entitled "8/19 Netscape Exec Meeting Agenda" by noting that "what is really important" includes Netscape's "Future growth plan. Any data analyst's have about how they will grow revenues. People are expecting Netscape to make a lot of money. How does that pencil out." GX 980; GX 981.

ii. Gates specifically requested such data on "how much software companies pay Netscape" from his staff in December 1996. He wrote: "In particular I am curious about their deals with Corel, Lotus and Intuit. All of these ship a lot of units of Netscape. In our discussions we must have some kind of sense of the revenue which Netscape gets from this." GX 345.

298.5.3. Cameron Myhrvold's testimony that Microsoft studied Netscape's revenues simply to determine how better to compete (Myhrvold, 2/10/99pm, at 30:7 - 31:19), is not credible.

i. Cameron Myhrvold wrote, in October 1997, "NetScape's client revenue -- is it rising (hope not), falling (I think so), and <u>do we think they are getting any money from ISPs/netops for their browser</u>? -- If so, <u>which netops are still paying them</u> and construct a hunting list for us to go after." GX 117 (emphasis in original).

ii. See GX 701 (12/97 Myhrvold e-mail describing "our progress agianst [sic] the netscape hunting list," referring to Microsoft's successes in cutting deals with Netscape's ISP accounts); Myhrvold, 2/10/99pm, 33:22 - 34:14 ("I certainly wondered whether Netscape could keep up the pace of innovation if they weren't making money from that" ISP "channel . . . So, really, it would be a question as to whether Netscape would choose to continue to invest in the browser if they weren't making money there.").

2. Microsoft incurred hundreds of millions of dollars in costs in its effort to gain browser usage share

299. Although Microsoft gave Internet Explorer away for free, it spent hundreds of millions of dollars on developing and marketing Internet Explorer in order to gain browser usage share and blunt the platform threat.

299.1. Microsoft spent tens of millions of dollars each year from 1995 to the present developing Internet Explorer to run with Windows 95 and Windows 98.

i. Microsoft represented in an interrogatory answer that its development expenses for Internet Explorer were on the order of $100 million each year. Fisher, 1/12/99am, at 35:13-19; Schmalensee, 1/20/99am, at 47:8-18. Schmalensee Direct ¶ 211 ("Microsoft reportedly has spent more than $100 million annually in developing Internet-related technologies for Windows . . . .").

ii. Dean Schmalensee testified that the figure of half a billion dollars is broadly consistent with his understanding of how much Microsoft has spent overall to develop Internet Explorer. Schmalensee, 1/20/99am, 48:9-15.

iii. According to Brad Chase: "The cost of rebuilding complex software from the ground up is high." He further testified that Microsoft "dedicated a team of more than 100 developers to the Internet Explorer 3.0 effort. To put that number in perspective, the original Internet Explorer 1.0 team consisted of five or six developers." Chase Dir. ¶ 20.

iv. Microsoft's February 1998

GX 428, at MS7 00389 (sealed).

299.2 Microsoft also spent millions developing Internet Explorer for other operating systems.

i. <u>See</u> <u>supra</u> Part V.B.1.c.; ¶ 113.

299.3. Microsoft spent millions marketing and promoting Internet Explorer.

i. A memo to Bill Gates entitled "think week" about "How to Get To 30% Share In 12 Months," stated: "Content drives browser adoption, and we need to go to the top five sites and ask them 'What can we do to get you to adopt IE?' We should be prepared to write a check, buy sites, or add features -- basically do whatever it takes to drive adoption." GX 334, at MS98 0104679; GX 684 (same document).

ii. In an "Internet Browsers" presentation, Maritz concluded that to gain share, Microsoft would engage in "Massive seeding of IE. Magazines, tradeshows, via partners, high profile events etc. IE being free is a key advantage to push . . . . Pay for premium merchandising positions." The presentation contemplated for Internet Explorer "Broad advertising on the web & with traditional media?" GX 473.

iii. In May 1996, Bill Gates sent a memo to senior executives describing "lots of ways to spend money" to promote "the browser," including advertising ("Clearly we need to do a lot of this . . . .") and expenditures on distribution including "massive airdrops"). GX 41.

iv. In July 1997, Paul Maritz noted the high cost of marketing Internet Explorer and the reasons for it: "There is talk about how we get more $'s from the 1000+ people we have working on browser related stuff" than from increasing Windows 98 branding, "but I have not lost sight of the fact that Browser Share is still an overwhelming objective. You may notice that I have kept IE marketing spend [sic] at <u>very</u> high level through FY '98. [sic] and resisted pressure to reduce this or switch it to other products. I also said 'no' on the proposal to charge separately for the Shell." GX 112 (emphasis in original).

v. See Mehdi Dep., 1/13/99, 559:4-20 (IE FY97 marketing budget roughly $30 million); GX 511 (Chase wrote to Microsoft senior executives in April 1997: "Browser share needs to be a top priority around the world. Marketing budgets, including mine, should be budgeted about equal to this year (we are doing a bottom's [sic] up IE budget now, last year including some drg [Developer Relations Group] efforts I was around $69M)."); GX 795; GX 696 (sealed).

299.4. Microsoft also spent millions, both in direct payments and through giving away valuable Windows "real estate" and other property, to induce third parties to favor Internet Explorer and disfavor rivals.

299.4.1.1. Microsoft paid OLSs and ISPs to gain browser usage share.

299.4. Microsoft, through its ICW and OLS Folder contracts, paid ISPs and OLSs to favor Internet Explorer and severely restrict their distribution and promotion of browser rivals.

i. Microsoft "made a considerable investment in order to establish the Windows Referral Server," (Myhrvold Dir. ¶ 49) including spending between four to five million dollars a year to lease the network, in addition to the development of software and 24-hour per day maintenance of servers. Myhrvold, 2/10/99am, at 27:17 - 28:6.

i(A). Microsoft's proposed findings reiterate that Microsoft "never made any profits from referral fees paid by the ISPs that appeared in the Windows 95 referral server; to the contrary, the costs of running the Windows referral server thus far have exceeded the payments Microsoft has received from ISPs for referring subscribers to them." (MPF ¶ 746).

ii. Microsoft traded placement in the referral server and the online services folder for the promotion of Internet Explorer and the exclusion of rivals. See supra Part V.D.3.b; ¶¶ 227-236.

iii. Microsoft's own proposed findings detail the amount of the investment Microsoft made for OLSs that agreed to distribute Internet Explorer to the exclusion of browser rivals. (MPF ¶ 713).

299.4.1.2. Microsoft paid ISPs bounties, and (in some cases) direct cash payments, to convert their installed base to Internet Explorer.

i. Microsoft gave Netcom a nine dollar discount for every Internet Explorer distributed to the installed base. Myhrvold, 2/10/99pm, at 11:18 - 13:2; GX 81.

ii. Microsoft planned to convert "existing Nscp users" through the "ISP bounty program," according to a January 1997 presesntation entitled "NC & Java Challenge." GX 51, at MS7 005539.

iii. Myhrvold explained the mechanics behind Microsoft's payment to ISPs to convert their installed base to Internet Explorer. Microsoft offered discounts off of the referral fees owed to Microsoft for subscribers gained through the Internet Referral Server for "distributing Internet Explorer to existing users of Netscape Navigator." Myhrvold Dir. ¶ 62. GX 1141, at MS6

5000017 (Exhibit D4;

(sealed); GX 1144 (Spry agreement) (sealed) ; GX 1146 (Mindspring agreement) (sealed).

iv. Microsoft entered into a contract with AOL to promote Internet Explorer through distributing it to AOL's installed base. The contract provided that AOL would be paid $0.25, up to a limit of one million, per conversion to Internet Explorer. GX 1019 (AOL Access Software Advertising and Promotion Agreement); GX 978 (summary of Internet Explorer promotional agreement). Brad Chase summarized the agreement in an internal Microsoft e-mail: "It works as follows: if they convert 4M of their users to a client using IE 3 by 2/1/97, i will give $1.5M. If they get an additional 2M by 4/2/97, I will give them $500K more." GX 976.

v. In addition, the contract between Microsoft and in the Microsoft Referral Server provided that would receive fees for each new subscriber who already uses Internet Explorer or upgrades to Internet Explorer. GX 1069, at MS98 0101395 (Exhibit 3) (sealed).

vi. **<u>See</u>** **<u>also</u>** Part V.D.3.a.; ¶ 226.

299.4.1.3. Microsoft paid ISPs to use Internet Explorer-specific technologies, which Microsoft expected to influence web site standards and increase Internet Explorer usage.

i.

GX 1132

ii. Microsoft gave discounts off referral fees for the use of

Internet-Explorer specific technologies. GX 1141 (Earthlink) (sealed); GX 1144 (Spry contract) (sealed); GX 1146 (Mindspring) (sealed).

iii. Dr. Warren Boulton concluded that, because Active X is "operating system (typically Windows) specific," the effect of the provision giving discounts for the use of Active X "is to reward ISPs that configure their services in a way that reduces the cross-platform threat to Microsoft's operating system monopoly. The reason is that ISP use of Microsoft-specific technologies reinforces the dominance of the Windows platform." Use of "such technologies by ISPs serves to blunt the cross-platform threat" that "rival browsers might pose." Warren-Boulton Dir. ¶ 108.

299.4.1.4. Microsoft paid ISPs in other ways to favor Internet Explorer over rivals.

i. In a presentation on "Internet Browsers," Maritz listed, among other inducements, the following to get Internet Explorer share: "ISPs. Allow ISPs to be in Windows and the Internet Starter Kit . . . . Provide customization opportunities so ISPs can brand their offering and add specific features. Co-marketing funds to encourage ISP partners to promote our browser and get new customers for them." GX 473, at MS6 6006248. See also MPF ¶ 717.

ii. Microsoft paid ISPs and others to buy out contracts that the ISPs had with Netscape to distribute Netscape's browser. Schmalensee, 1/20/99am, at 56:19 - 57:23.

iii. Microsoft offered, in attempting to induce AT&T to enter into a contract favoring Internet Explorer, to pay off up to $17 million in minimum commitments owed to Netscape. GX 179. In addition, Microsoft created a co-marketing fund for the distribution of Internet Explorer that consisted of a $5 credit for every copy of Internet Explorer distributed, not to exceed $5 million. Myhrvold Dir. ¶ 29.

iv. See also supra Part V.D.3.; ¶¶ 224-239 (detailing the large value Microsoft bartered with AOL and other ISPs for exclusionary terms); Barksdale ¶ 142 (citing GX 75).

v. **See also MPF ¶ 717.**

299.4.2. Microsoft paid ICPs in order to gain browser usage share.

299.4.2.1. Microsoft exchanged placement on the channel bar for ICPs' agreement to restrict their dealings with browser rivals and adopt Internet Explorer-specific technology.

i. See supra Part V.E.2.; ¶¶ 264-275.

299.4.2.2. Microsoft paid ICPs in other ways.

i. In his February 1996 memorandum "Internet Browsers; 1. Netscape's actions; 2. How to Win," Paul Maritz outlined plans for ICPs: "Build 'first wave' like programs to provide value to ICPs that build on our platform and use our logo" and to set aside a "special marketing pool of $30M to build co-marketing opportunities with the key site." GX 473, at MS6 6006231; MS6 6006248.

ii. In June 1996, Brad Chase reported to Paul Maritz and Brad Silverberg on a "tremendous" deal just struck with Starwave, which operates of the ESPN Sportszone website -- which Chase characterized as "one of the top few sites on the internet . . ." -- and the Family Planet website. Under the terms of the deal, Microsoft agreed to pay Starwave a flat fee of $500,000 plus a per-head bounty, up to a total of $1.2 million. In return, Starwave committed throughout 1996 and 1997 both to undertake activities to promote Internet Explorer and not to undertake activities with Netscape. GX 862.

iii. Barksdale testified about several similar episodes. Barksdale Dir. ¶¶ 186, 188, 189, 190, 200; GX 72; GX 79; GX 85; GX 90; GX 94; GX 1250.

299.4.3. Microsoft used costly Market Development Agreements ("MDAs") with OEMs to gain browser usage share.

299.4.3.1. Microsoft offered OEMs MDA discounts and other consideration to promote Internet Explorer.

i. In many or all of its 1996 MDAs (effective in 1997), Microsoft gave a discount to OEMs if the OEM displayed the Internet Explorer logo on the OEM's home page and linked the home page to Microsoft's Internet Explorer update page. For example, Gateway could earn $3.00 per system worldwide for performing these promotional activities plus two others not directly concerning Internet Explorer. GX 1498 (sealed); see also GX 1506 (HP) (sealed); GX 1503 (IBM) (sealed); GX 1493 (AST) (sealed); GX 1509 (Hitachi) (sealed); GX 1511 (Packard Bell) (sealed); GX 192 (NCR).

ii. GX 1169 (HP) (sealed); GX 1171 (Dell) (sealed); GX 1171A (Dell) (sealed); GX 1173 (Gateway) (sealed); GX 680 (Toshiba) (sealed).

iii. GX 1169 (HP) (sealed); GX 1171 (Dell) (sealed); GX 1171A (Dell) (sealed); GX 1173 (Gateway) (sealed); GX 680 (Toshiba) (sealed).

Compaq ($1.00/CD) and HP. GX 163 (Compaq) (sealed); GX 1169 (HP) (sealed).

iv. GX 979 (sealed).

299.4.3.2. Microsoft offered OEMs MDA discounts and other consideration to make or promote Internet Explorer as the default, preferred, or exclusive browser.

i. See supra Part V.C.2.a.(2); ¶ 203.

ii. In a May 27, 1998, draft "IE5 OEM Marketing Review," Microsoft listed as "PHASE IV - Encourage, PR, Launch," that it would "Explore joint marketing opportunities to solicit Netscape users to convert to IE5." GX 233, at MS98 0125666.

iii. In March 1996, Nick Zaharias reported to other Netscape executives that Dell's Director of Software Procurement told him that "Microsoft is willing to make Internet Explorer 'better than free' in exchange for a positioning statement that would make MSIE the 'browser of choice' or 'preferred product.'" He said Zenith Data Systems had had a similar offer. GX 182; GX 236.

iv. In November 1996,

GX 758 (sealed). A January 1997 internal Compaq e-mail reports that Joe Williams of Microsoft had confirmed in principle Microsoft's offer to share

ISP revenues with Compaq. GX 1041.

v. Barksdale testified that his salespeople had reported to him several instances in which “OEMs were offered a discount on Microsoft products, including Windows, if they would make Internet Explorer their ‘preferred’ browser.” Barksdale Dir. ¶ 165 (citing GX 87, GX 188, GX 199). The Netscape salespeople reported that the threat to raise Windows royalties “has always been done verbally and they never left any evidence.” GX 188.

vi.

GX 1498 (sealed).

vii.

GX 1155 (sealed).

299.4.3.3. Microsoft offered OEMs MDA discounts and other consideration to adopt IE-specific technologies.

i. See supra Part V.C.2.(a); ¶ 203.1.

299.4.4. Microsoft paid ISVs to gain browser usage.

299.4.4.1. Microsoft entered into First Wave agreements that gave ISVs preferential access to Microsoft “Beta” releases of Windows in exchange for preferential terms for Internet Explorer.

i. In exchange for, among other things, access to so-called "Beta" releases of Microsoft operating system products, participating ISVs agreed that: "If the user interface is HTML based, Internet Explorer 4.0 must be set as the default browser." GX 2071 (Symantec) (sealed); Microsoft entered into dozens of such or similar agreements with leading ISVs. GXs 2400 - 2497 (sealed).

299.4.4.2. Microsoft sought to bribe ISVs in other ways to gain browser usage share.

i. In July 1996, Bill Gates told the CEO of Intuit, Scott Cook, that if Cook "had a favor we could do for him that would cost us something like $1M to do that in return for switching browsers in the next few months I would be open to doing that." GX 94.

299.4.5. Microsoft paid end users and other firms to gain browser usage.

i. Barksdale testified concerning numerous instances in which Microsoft offered end users significant consideration for exclusively using Internet Explorer. Barksdale Dir. ¶ 187 (testifying that Intelligent Electronics was offered $100,000 as part of a deal requiring exclusive use of Internet Explorer); GX 104 (in January 1997, Microsoft offered Intelligent Electronics $100,000 as part of a deal requiring exclusive use of Internet Explorer.) Barksdale Dir. ¶ 199 ("Microsoft offered to upgrade telecom New Zealand's 9000+ Win 3.1 terminals to Windows 95 for free if Telecom would use Internet Explorer as its internal browser."); Barksdale Dir. ¶ 202 (International Paper); <u>see</u> <u>also</u> GX 74; GX 77.

ii. Netscape understood that Microsoft was "going into all major accounts" that Netscape contacted in Brazil, and offered, among other things, to pay "$1.00 to take each navigator out of the account," "Support and provide all of their products and give mktg dollars to support vendors in trade shows, conferences etc.," and "Give MS Explorer for free for 2 years." GX 1251

3. Microsoft also sacrificed revenue from other products to gain browser usage share

300. Microsoft also deliberately sacrificed revenue from other products in order to implement its campaign to gain browser usage share.

300.1. Microsoft's coercive conduct, including its screen restrictions and its requirement that all OEMs, regardless of preference, distribute Internet Explorer, diminished the value of Windows to OEMs and thereby reduced the price OEMs were willing to pay for Windows.

i. Dr. Warren-Boulton testified: "Microsoft's tying of IE to its operating system made distribution of rivals browsers infeasible or more costly for OEMs and thus reduced the OEMs' demand for Windows." Warren-Boulton Dir. ¶ 189.

ii. Microsoft's screen restrictions, as explained, imposed significant costs on OEMs, inhibited their ability to differentiate their products and best serve users, and thus reduced the value of Windows to both OEMs and end users. See supra Part V.C.1.b.(1); ¶ 178 - 178.4.

iii. Dean Schmalensee confirmed that economists look to more than just the price terms of a product in determining the real cost of the product to customers. He testified in a previous case (Data General), where he believed that the defendant had engaged in a tie-in of two products, that: "You must realize, parenthetically, by price, an economist means not only the dollars paid, but everything else that affects price." Schmalensee, 1/19/99am, at 41:14 - 45:4.

300.2. Microsoft's use of desktop placement to gain browser usage share reduced its revenues from MSN and other products (such as from selling distribution with Windows itself).

i. See supra Part V.D.3.b.(2); ¶ 232 (detailing Gates' concern that putting AOL in the "Windows box" would put a "bullet through MSN's head").

ii. Professor Fisher testified that the opportunity cost to gain share for Internet Explorer Microsoft incurred included "offering places on its desktop real estate that was valuable to the recipient and for which Microsoft could otherwise have charged." Fisher, 6/1/99am, at 69:19 - 70:9; see also GX 868D.

iii. Dr. Warren-Boulton testified: "Microsoft's agreements with ISPs and OLSs provided those firms with preferential access on highly desirable terms to valuable Desktop real estate. This is an unique asset; its value was enhanced by the OEM screen restrictions; and it could have generated substantial direct revenue for Microsoft if it had been sold rather than bartered or exchanged for exclusivity agreements." Warren-Boulton Dir. ¶ 189.

4. At the time it incurred its immense browser-related costs, Microsoft did not anticipate recoupment except through weakening browser rivals and thereby protecting its operating system monopoly

301. Microsoft anticipated recouping its browser-related costs by weakening browser rivals and thereby protecting its operating system monopoly.

i. Brad Chase wrote, in an April 4, 1996, memorandum entitled "FY 97 Planning Memo 'Winning the Internet platform battle,' under the heading "<u>Why should you care?</u>,': "This is a no revenue product, but you should worry about your browser share as much as BillG because" Microsoft "will loose the Internet platform battle if we do not have a significant user installed base. The industry would simply ignore our standards. Few would write Windows apps without the Windows user base." GX 39, at MS6 5005720 (emphasis in original).

ii. Paul Maritz wrote on June 20, 1996: "Without browser share, everything is very hard. So job #1 is browser share. We also have to persuade approx 5 million persons to start using IE over the next 6 months." GX 42.

iii. An internal Microsoft presentation for a meeting hosted by executive Brad Silverberg states, under the heading "Internet Battle": "This is not about *browsers*. Our competitors are trying to create an alternative <u>platform</u> to Windows. They are smart, aggressive, and have a <u>big lead</u>." GX 40 (emphasis in original).

iv. Paul Maritz wrote on July 11, 1997: "There is talk about how we get more $'s from the 1000+ people we have working on browser-related stuff, but I have not lost sight of the fact that Browser Share is still an overwhelming objective. You may notice that I have kept IE marketing spend [sic] at <u>very</u> high level through FY'98, and resisted pressure to reduce this or switch it to other products. I also said 'no' on the proposal to charge separately for the Shell." GX 112 (emphasis in original).

v. Brad Chase wrote on April 8, 1997: "Last year, and before that, we went on a jihad as we saw the threat to our platform from Netscape Navigator." Chase further explained that “it’s critical that we maintain our focus on gaining browser share.” GX 511.

vi. In April 1997, Chase wrote, “IE share is critical. Without it, we lose the desktop, which translates to Windows and Office revenue over time.” GX 59. He had also expressed this idea earlier that month in memorandum, “FY98 Planning Memo ‘Preserving the Desktop Paradise’.” GX 510, at MS7 004127.

vii. Paul Maritz wrote on July 14, 1997, in response to a suggestion that Internet Explorer 4 be shipped separately from Windows 98 and sold for a positive price as part of the Windows 98 upgrade product, that charging for Internet Explorer “is tempting, but we have to remember that getting browser share up to 50% (or more) is still the major goal.” GX 113.

viii. Dr. Warren-Boulton testified: “The available evidence indicates that Microsoft pursued the practices I have examined for the purpose of preserving its Windows operating system monopoly and gaining monopoly power in the browser market, and pursued them without regard to whether they would have been profitable in their own right. Accordingly, it is my opinion that Microsoft’s intent in engaging in this course of conduct, when considered as a whole, was predatory.” Warren-Boulton Dir. ¶ 185.

ix. Professor Fisher testified: “Microsoft internal documents make clear that Microsoft undertook its browser development not to make money from browsers, not because doing so would 'make sense from a business standpoint' on its own, but to prevent Netscape's browser from facilitating competition with Microsoft's monopoly operating system.” Fisher Dir. ¶ 124. Professor Fisher further testified that “It is important to note that this is not merely colorful language that could be interpreted either as aggressive competition or as evidencing a predatory intent (for example, language like: 'Our goal is to get 100% of the business' or even like 'Let's kill the competition'). This is language that accurately describes the purpose and effect of Microsoft's conduct--distribute its browser at a zero or negative price in order to eliminate competition.” Fisher Dir. ¶ 126.

302. There is no contemporaneous evidence that Microsoft anticipated any other way of recovering its massive Internet Explorer related costs.

i. Professor Fisher explained the purpose of looking at contemporaneous evidence: “what matters is what is expected (or can reasonably be expected) at the time the action in question is taken." Fisher Dir. ¶ 49.

ii. Professor Fisher testified: “This was a serious expenditure of money. What was happening here with the browser was a big effort for Microsoft. They spent a lot of money -- hundreds of millions -- to develop the browser. They gave away valuable real estate. They, in effect, paid people to take it. And this was a no-revenue product -- explicitly a no-revenue product. Serious businesses -- and I certainly take Microsoft to be a serious business -- don't typically engage in activities like that, unless there is some relatively formal or even -- relatively formal showing that it's going to bring in revenues, and, therefore, be a profitable thing to do. I know of no document that suggests that at all, and I know of no document -- and I certainly know of no document that can be called anything like a formal business plan that shows those revenues and shows that this is going to be a profit-maximizing choice." Fisher, 1/12/99am, at 34:11 - 35:12.

iii. Professor Fisher further testified: "Microsoft's documents do not say, 'we're doing this with Internet Explorer because Internet Explorer is going to bring in a lot of money.' In fact, contemporaneous documents do not suggest that Microsoft cared at all about -- and some of its actions also confirm this -- that Microsoft cared at all about the ancillary revenues that might" be "derived from giving away Internet Explorer." Rather, "Microsoft's documents are full of statements" that "'This is a no-revenue product, but you should care about it just as much as does Bill Gates. Without winning the browser war, we lose.'" Fisher, 6/1/99am, at 40:7-25; 68:18 - 69:10 (explaining that Microsoft's documents confirm that Microsoft engaged in its browser-related conduct "to protect" its "monopoly power," particularly the document states that "without browser share, we lose -- and then it makes mention of both, I think, Windows and office").

iv. Dean Schmalensee conceded that he did not "see any analysis of the revenues that Microsoft expected to receive, or any written indication of the revenues that Microsoft expected to see from the browser in 1994 or 1995 or 1996 or 1997." Schmalensee, 6/24/99pm, at 16:12-21.

303. Because Microsoft expected to protect its operating system monopoly by weakening browser rivals, it priced the browser without regard to cost.

i. During the negotiations for the Internet Explorer promotional agreement with AOL, Colburn was told that "Microsoft had no limitations on what it could spend to gain market share for Internet Explorer." Colburn Dir. ¶¶ 38-39; GX 689 (AOL e-mail reporting that Microsoft could spend any amount to gain market share for Internet Explorer).

ii. Dr. Warren-Boulton testified that he had seen no documents dating from the time that key decisions about Internet Explorer were made to indicate that Microsoft ever performed a calculation comparing the costs it "incurred through its pricing policies and exclusionary agreements" regarding Internet Explorer to the "revenues Microsoft could have expected to gain absent any effect on the competitiveness of the browser and operating system markets." Warren-Boulton Dir. ¶193.

iii. Paul Maritz's trial testimony about whether or not Microsoft tracked the development expenses of the browser when it was actually being developed and priced is internally contradictory, confusing, and incredible.

- First, Maritz said that he could quantify "how much money it cost" Microsoft "to develop Internet Explorer" by looking at, among other development expenses, salaries of employees, capital equipment, and corporate overhead. Maritz, 1/26/99pm, at 6:11-23. He further testified, in contradiction to Dean Schmalensee's testimony that records at Microsoft of this sort did not exist, that these figures "would have been prepared in the normal course of business," and that he personally became aware that Microsoft was tracking Internet Explorer development expenses in the "middle of fiscal year 96." Maritz, 1/26/99pm, at 8:5 - 10:10.

- At his deposition, however, Martiz testified that he did not know whether Microsoft ever kept track of how much money it had spent on browsers, or whether Microsoft ever made an estimate of how much money it has spent on browsers. After he was shown this testimony, Maritz changed his trial testimony to admit that Microsoft never made an estimate of how much it spent to develop its browser and assert only that he could give an estimate of those costs if asked to figure it out today. Maritz, 1/26/99pm, at 10:14 - 13:22.

- Indeed, Maritz's testimony led the Court to observe: "I have here in my notes that prior to looking at his deposition, he said that the development of browser costs were tracked by Microsoft from '94 on, and then he became aware of it sometime in fiscal '96 . . . from that I inferred that he knew that there was some specific accounting of the investment in the browser. And then after he looked at his deposition, he seemed to think that the figures that he had were only bits of information which related generally to the development of Windows." Maritz, 1/26/99pm, at 17:10-21.

304. Microsoft's incurring of its massive browser-related costs and pricing the browser at zero did not otherwise "make sense from a business standpoint" and, therefore, cannot be explained except as part of a predatory strategy to weaken its browser rivals and thereby protect its operating system monopoly.

i. Professor Fisher testified that, absent maintenance of its operating system monopoly, Microsoft’s conduct does not make sense and is not profitable:

- C “Without the gain to Microsoft that will result from preserving its highly profitable operating system monopoly and from monopolizing the browser market, Microsoft's conduct does not 'make sense from a business standpoint.' It is giving away, indeed paying people to take and distribute, something that it has spent a lot of money to develop and distribute and something for which the leading competitor was charging.” Fisher Dir. ¶ 127.

- C “It is only when Microsoft's gains from preserving and extending its monopoly are included that Microsoft's conduct is profitable.” Fisher Dir. ¶ 128.

- C “Microsoft's price for its browser, together with its other actions, is not profit-maximizing except for its effect of preserving Microsoft's operating system monopoly (and possibly gaining further monopoly profits by monopolizing the browser market and its ancillary revenues).” Fisher Dir. ¶ 241.

- C “Microsoft was interested in 'winning the browser battle' not because of the revenues it would bring in directly, but because of the effect that would have in protecting Microsoft's operating-system monopoly. In order to do that, they were not merely interested in how well they would do. They were also particularly interested in being sure that Netscape did not do well in browsers.” Fisher, 1/12/99am, at 40:25 - 41:9.

ii. Dr. Warren-Boulton reached the same conclusions.

- C “Microsoft’s conduct, in the aggregate, was not expected to be profitable except for the market power Microsoft expected to gain from the exclusion of browser rivals and therefore was predatory.” Warren-Boulton Dir. ¶ 195.

- C “The available evidence indicates that Microsoft pursued the practices I have examined for the purpose of preserving its Windows operating system monopoly and gaining monopoly power in the browser market, and pursued them without regard to whether they would have been profitable in their own right. Accordingly, it is my opinion that Microsoft’s intent in engaging in this course of conduct, when considered as a whole, was predatory.” Warren-Boulton Dir. ¶ 185.

305. Microsoft’s pricing of Internet Explorer was not profitable (absent monopoly recoupment).

305.1. Microsoft's pricing of Internet Explorer was predatory because the development and distribution costs exceeded the revenues that Microsoft could reasonably have anticipated because of the zero price.

i. Professor Fisher testified that Microsoft's actions "were simply not profitable at all on any standard." Fisher, 6/1/99am, at 37:21 - 38:4.

ii. Dr. Warren-Boulton testified: "The evidence I have seen supports the inference that Microsoft took exclusionary actions and incurred costs without regard to whether its actions were profit-maximizing – or even profitable – absent the future revenue gains from weakening rival browsers and thereby preserving its Windows operating system monopoly and from gaining monopoly power in the browser market. Instead, Microsoft viewed winning browser share at almost any cost as being of overwhelming strategic importance." Warren-Boulton Dir. ¶ 194.

iii. Microsoft attacks a straw man when it argues (MPF ¶ 469) that Professor Fisher based his predatory pricing analysis on the proposition that it is anticompetitive to charge "less than the short-term profit maximizing price." To the contrary, as noted, Professor Fisher unequivocally testified that Microsoft's prices were below cost and that Microsoft's conduct is predatory even under the test endorsed by Dean Schmalensee. Fisher, 6/1/99pm, at 35:9 - 40:6**. Professor Fisher made clear that "sensible firms . . . do not maximize short-run profits, period. And sensible monopolies, I suppose, do not maximize short-run monopoly profits. They are typically interested -- and appropriately so -- in long-run profits."** Fisher, 6/4/99am, at 13:7-12**.**

305.2. Microsoft's pricing was predatory, even considering only the costs associated with Microsoft's provision of Internet Explorer separately from Windows.

i. Professor Fisher testified that Microsoft's conduct was not profitable because "Microsoft gave away Internet Explorer. It was to be forever free. Microsoft's documents describe it correctly as 'This is a no-revenue product.' Now, this was a product which Microsoft not only gave away for free, but basically bribed people to take. They gave them preferred places on the desktop for which" Microsoft "could have charged. But beyond that, they also spent hundreds of millions of dollars on the development of this no-revenue product, and then they gave away the technology. That is not a profitable act, except for the protection of the operating system's monopoly." Fisher, 6/1/99am, at 39:14 - 40:6.

5. The effect of Microsoft's predatory pricing of Internet Explorer has been to impede rivals, harm consumers, and facilitate Microsoft's objective of blunting the browser threat

a. Microsoft's predatory pricing injured competition

305.2A Microsoft's criticism of plaintiffs' economists for not quantifying precisely the costs and reasonably anticipated benefits of Microsoft's browser-related expenditures (MPF ¶¶ 468, 473-475) is misplaced.

305.2A.1. Professor Fisher and Dr. Warren-Boulton both determined that the costs to Microsoft of its efforts to increase its browser share were very large (in the hundreds of million of dollars), while the expected benefits of its zero price that do not depend on preserving its operating system monopoly were either very small or nonexistent. In these circumstances, more precise quantification of either costs or benefits was unnecessary.

i. **See** **supra** Part V.G.4.; ¶¶ 305.1, i-ii**;** 305.2.i**.**

ii. Professor Fisher explained that Microsoft's sacrifice of considerable ancillary revenues and conduct that did not increase, but rather decreased, demand for Windows -- such as hindering Netscape -- show that any benefits that do not depend on protecting of its operating system monopoly cannot possibly

cover Microsoft's large browser-related expenditures. Fisher, 6/1/99am, at 63:15 - 70:12**.**

iii. **See also** Warren-Boulton Dir. ¶¶ 185-195**.**

305.2A.2. Microsoft's suggestion that precise quantification of costs and revenues is a prerequisite for determining whether conduct is predatory is ironic in light of the fact that Microsoft made no contemporaneous effort to quantify costs and revenues when it decided to make Internet Explorer "forever free."

i. **As Dr. Warren-Boulton explained: "Ideally, one would like to measure the costs Microsoft incurred through its pricing policies and exclusionary agreements and to compare those to the revenue Microsoft could have expected to gain absent any effect on the competitiveness of the browser and operating system markets. There are, however, no data currently available to me that would provide an accurate estimate." Warren-Boulton Dir. ¶ 193.**

ii. **<u>See</u> <u>also</u> <u>supra</u> Part V.G.3.; ¶ 302.**

306. Microsoft's predatory pricing of Internet Explorer increased its share at rivals' expense.

i. As Professor Fisher explained, it is the combination of offering a browser that was roughly equivalent to Netscape Navigator, and offering it at a zero price, that increased Internet Explorer's share. Fisher, 6/2/99am, at 8:5-17 (testifying that he doesn't "deny that an improved IE was required to make Microsoft's strategy succeed. Predation pricing, to succeed, has got to be the offering of an unprofitably low price for a product that, at the lower price, consumers will want. That means you've got to have an adequate product that consumers will really want at the low price. So long as IE was quite inferior . . . offering it at a zero price would not be sufficient to persuade customers to take it.").

ii. Dean Schmalensee acknowledged that Earthlink "represented one of the many ISPs that struggled to justify paying to distribute Netscape's client products when they could distribute the improved internet Explorer for free." Schmalensee Dir. ¶ 277.

307. Microsoft's predatory pricing injured its principal rival, Netscape, in other ways as well.

307.1. Microsoft’s predatory pricing deprived Netscape of browser revenue, thereby impeding its ability to innovate.

i. Graphs of Netscape’s quarterly browser licensing revenues show that those revenues had been reduced to zero by Q1 1998. GX 9; GX 10. Likewise, Netscape’s 1997 Annual Report identified its client stand-alone revenues for 1997, 1996 and 1995 as $105.5 million, $181.2 million, and $77.5 million, respective. The Report concludes: “The decreases in all periods as a percentage of total revenues as well as the absolute dollar decrease in 1997 were due to increased price pressure from Microsoft Corporation, a competitor that offers its browser with no licensing fees. In January 1998, Netscape announced that it would offer its client software for free. As a result, Netscape does not expect to generate any further significant client stand-alone revenue.” GX 367.

ii. James Barksdale testified: “We have already cut back on some of the things we wanted to do and extensions and expansions . . . . We depended on revenue to fund all of these new ideas. . . . So the money we were making was what was allowing us to do these things. If we don't bring in the revenue, by definition, you were trapped, and you were less innovative and less responsive to market opportunities.” Barksdale, 10/27/98pm, at 24:5- 25:3; see also Barksdale, 10/21/98pm, at 55:3 - 56:25 (Microsoft’s pricing strategy has led to less investment, and therefore innovation, in browsers at Netscape); Barksdale, 10/27/98pm, at 20:4-12 (browser revenue was “absolutely” vital to Netscape’s ability to continue to improve the product: “We had a payroll to make”).

iii. Marc Andreessen testified that “it became clear to us in the ‘96-97 time frame that it was not an economically feasible proposition to continue that development path. We would never generate a return.” He testified that this problem arose from pricing pressure on browsers “ultimately down to zero,” lack of access to OEM, ISP, and other channels, and a broad range of sales and marketing tactics by Microsoft. Andreessen Dep., 7/15/98, at 130:4 - 131:9 (DX 2555). He further testified that Netscape’s change in focus from the client to the server was motivated by “every reporter and analyst in the world believing that Netscape was going to go bankrupt because we were dependent on that revenue . . .” from the browser “and also every customer in the world believing that Netscape was going to go bankrupt. Not every customer, but many.” Andreessen Dep., 7/15/98, at 137:16 - 138:7 (DX 2555); see also Andreessen Dep., 7/15/98, at 138:8-21 (DX 2555)

iv. Scott Bosworth of IBM testified that Netscape's concern that the browser was "no longer a viable area for it to invest in" was the main reason that the Java browser work was dropped. (Bosworth Dep., 10/16/98, at 80:10 - 81:5 DX 2609).

v. Dr. Warren-Boulton testified that "given the zero pricing for browsers, given the absence of revenue from that source," Netscape "had decided to reduce its investment in updating the browser." Warren-Boulton, 11/24/98am, at 74:8-13.

307.2. Microsoft's predatory pricing deprived Netscape of distribution through OEMs and ISPs, further injuring Netscape's ability to maintain share.

i. In a memo to FY'97 WWSMM Attendees in April 1996 regarding "FY97 Planning Memo 'Winning the Internet platform battle,'" Brad Chase wrote: "you should go out to all the significant ISPs and on-line services in your country in May and close licensing agreements. You should also be able to break most of Netscape licensing deals and return them to our advantage because our browsers are free." GX 465, at MS6 6002322.

ii. Cameron Myhrvold noted the impact of Internet Explorer's "preferred" licenses to ISPs (for which Microsoft did not charge): "Technically they can also distribute other browsers but in fact very few do simply because of our better economics." GX 193.

iii. Internal correspondence in January of 1996 between Netscape's Peter Thorp and Ram Shriram, reveals that in negotiations with PSI, an ISP that was interested in licensing Navigator, PSI indicated that "Microsoft is offering to give them the world for free. They really want to do this deal and go with Netscape, but free tough to argue with." GX 65; Barksdale Dir. ¶ 140 (discussing GX 65).

iv. The President of Global Telecom wrote that "Microsoft gave me a deal I couldnt [sic] refuse. Free dialer, browser, developer kit, freely distributable, etc. . . . I know Netscape is better, but $0 vs $18K is impossible to beat." GX 73; Barksdale Dir. ¶ 149 (discussing GX 73).

v. As a result of Microsoft's "constriction of Netscape's distribution channels," by 1997 Netscape's browser revenues were significantly reduced. Barksdale Dir. ¶ 219. A chart prepared by Barksdale demonstrates Netscape's revenue growth flattening then declining through the first quarter of 1998. Barksdale

Dir. ¶ 219.

vi. See also GX 108 (MidOhioNet canceled Netscape account because Internet Explorer was free); GX 109 (same for Bliss Computer Services); GX 111 (same for Web Services Group); GX 115 (same for Mercury Internet Services); GX 116 (same for Seescape).

307.3. Netscape had to offer inducements similar to Microsoft's to retain market share, and that further deprived it of revenue needed to compete.

i. See infra Part VII.A.2.b.; ¶ 364.3.

308. Microsoft's predatory pricing also retarded the development of other browsers.

i. James Gosling testified: "The HotJava browser is a software application that was released by Sun in 1995. At the time the HotJava browser was developed, Sun contemplated undertaking the revisions and improvements necessary to maintain it as a competitive product for desktop computers such as Windows PCs. However, after Microsoft announced that its Internet Explorer browser would always be given away for free, Sun concluded that it made little business sense at that time to compete vigorously to sell a consumer browser application to compete against a product that was being given away for free." Gosling Dir. ¶ 37; see also Gosling, 12/3/98pm, at 80:17 - 81:3 (testifying that Sun never sold HotJava "as a commercial browser" because, "given that the market price for browsers, those days, seemed to be zero, it hardly seemed like a sensible thing to do.").

ii. Scott Bosworth testified that IBM did not, in early 1998, seriously consider sourcing a browser for use with JavaOS from a supplier other than Netscape or Sun or seriously consider building such a browser itself, because IBM believed no such investment was likely or profitable. He testified, "we all recognized the fact that anyone investing heavily into the browsers [sic] at this point in time was a pure and risky expense level with little return on that investment from a browser standpoint. No one believed that we should go get in the browser business." Bosworth Dep., 10/16/98, at 118:17 - 120:18 (DX 2609).

b. Microsoft's predatory pricing facilitated monopoly recoupment and injured consumers

309. Microsoft's predatory pricing of its browser harmed consumers because it contributed to the diminution of the platform threat Netscape posed and thereby facilitated maintenance of Microsoft's

operating system monopoly.

i. Professor Fisher concluded that Microsoft is already recouping in the form of preserving its monopoly power and that "its financial recoupment will occur from preserving the returns to the monopoly power in operating system, returns that might have been dissipated had it not acted in the way in which it did." Fisher, 1/12/99am, at 31:25 - 32:15.

ii. See generally infra Part VII.A.

6. The after-the-fact justifications Microsoft offered for its better-than-free pricing of Internet Explorer are pretextual and inconsistent with the evidence

310. Microsoft's contemporary documents indicate only a concern with eliminating Netscape as a platform threat. Microsoft's very different, after-the-fact explanations for its browser pricing are pretextual.

a. Microsoft's assertion that it reasonably expected its browser-related expenditures to be profitable because of expanded demand for Windows is pretextual

310A. Microsoft's focus on its decision to bundle Internet Explorer with Windows (MSF ¶¶ 465-484) is not responsive to the evidence that it set a predatory price for Internet Explorer.

310A.1. Microsoft's purported justification -- that bundling Internet Explorer with Windows increases sales of Windows -- has nothing to do with Microsoft's decision to give Internet Explorer away for free when provided separately from Windows, and even when provided -- at great expense -- for non-Windows operating systems.

i. See supra Part V.G.4.; ¶ 305.2.

310.A.2. Microsoft's defense of bundling also has nothing to do with either the

price or cost of Windows.

i. **Microsoft does not argue that bundling Internet Explorer with Windows reduced or enabled it to avoid any of the costs it incurred developing and promoting Internet Explorer. <u>See</u> <u>supra</u> Part V.G.2.; ¶¶ 299-300.**

ii. **Microsoft itself recognizes that Internet Explorer is a "no revenue" product and has promised that it will be "forever free" (Fisher, 6/1/99am, at 39:19 - 40:25) and thus does not argue that the price of Windows has increased because of the inclusion of Internet Explorer. <u>See</u> <u>supra</u> Part V.G.1.; ¶ 297.**

311. Microsoft's argument that it expected the free pricing of Internet Explorer to be profitable because it would increase demand for Windows is pretextual.

311.1. <u>First</u>, there is no contemporaneous evidence that Microsoft believed increasing demand for Windows would cover its immense browser expenditures. To the contrary, Microsoft was concerned only with increasing browser share.

i. <u>See</u> <u>supra</u> V.G.4.; ¶¶ 301-302.

ii. **Microsoft cites only a single document, in contrast to the numerous documents plaintiffs cited showing that Microsoft gave Internet Explorer away to preserve its operating system monopoly. <u>See</u>, <u>e.g.</u>,** GX 511**; <u>supra</u> Part.V.G.4; ¶¶** 301**,** 302**, Part V.G.6.a; ¶** 311**. And Microsoft's single document evidences not a procompetitive reason, but rather an anticompetitive one, to give away the browser. Microsoft cites only a partial sentence from Ben Slivka's 1995 memo, "The Web is the Next Platform." In fact, the entire sentence reads: "The client just helps us sell Windows; <u>we need to make it ubiquitous so that we can control the evolution of the Web</u>." MPF ¶ 477 (citing** GX 21, at MS98 0102407**) (underlined material omitted by Microsoft). In the context of the entire memo, which addresses "the Web as a threat to Windows" (**GX 21, at MS98 0102395**), Slivka's comment plainly reflects the view that promoting its own browser would help Microsoft protect its position in operating systems (notwithstanding Slivka's later, inconsistent deposition testimony cited by Microsoft (MPF ¶ 477)).**

iii. **Microsoft relies on a few sentences of testimony in this litigation by**

Microsoft executives Brad Silverberg and Yusuf Mehdi. MPF ¶¶ 470

(also citing Maritz Dir. ¶ 293**, not on point), ¶¶ 471, 478 (reproducing the relevant testimony). This testimony, along with Slivka's testimony discussed above, is neither contemporaneous nor objective substantiation of Microsoft's claim that, at the time of its investments, it expected its expenditure on Internet Explorer of hundreds of millions of dollars to pay off in sales of Windows.**

311.2. Second, there is no evidence that the additional demand for Windows created by making the browser free (rather than that demand created by offering the browser at a positive price) could compensate for Microsoft's immense browser-related costs.

i. Professor Fisher testified: "There is no reason to believe and . . . considerable reason not to believe -- that" the ancillary revenues Microsoft obtains from its negative pricing of the browser can "possibly lead to a recoupment of the amount of money that was spent on the development of Internet Explorer." Fisher, 6/1/99am, at 65:10-14; see also Fisher, 6/3/99am, at 25:18 - 26:1 ("The real question is . . . was there value to Microsoft . . . beyond the value that would have occurred had they charged separately for" the browser "and . . . then allowed Netscape to be distributed more widely." Although "there may be some" value, "there is" not "nearly enough to account for what happened.")

ii. Professor Fisher also testified: "Among the other revenues that Microsoft has claimed that it would get are revenues from increasing the sales of Windows. But the sales of Windows would have increased with any browser. And in any event, Microsoft gets to claim, in the analysis, not all the ancillary revenues that it gets from the sale of Windows because the browser way given away free, and not all the ancillary revenues that it gets from the browser anway. It gets to claim, at the most, the amount of ancillary revenues of either type that it got because of what it did, that it would not have gotten had it priced the browser separately." Fisher, 6/1/99am, at 64:24 - 65:9.

311.3. Third, Microsoft's real-world conduct shows that it was not trying to increase demand for Windows.

311.3.1. Demand for Windows is maximized by ensuring the availability of all good complements (including browsers) and satisfying end-user demand for a choice among complements.

i. Professor Fisher testified that "the more things that will run well on Windows . . . the more attractive Windows will be to users." Professor Fisher further explained: "Ordinarily" the producer of a product "would want to encourage other people to produce better complements because that would make" the product "better" and that giving "consumers a choice" between complements is "going to increase demand" for the product." Fisher, 1/7/99pm, at 52:19 - 54:2.

ii. Professor Fisher further testified: "As an analytical matter, if browsers are a complement to operating systems such that the sale of browsers that can be used with Windows will increase demand for Windows, it should not matter who makes the complement. But Microsoft cared greatly who makes the complement . . . Microsoft even tried to discourage Netscape from offering Netscape's browser for use with Windows--an action inconsistent with browsers being a complement to Windows, whose distribution Microsoft wanted to maximize." Fisher Dir. ¶ 129.

iii. Dr. Warren-Boulton testified: "Microsoft has a legitimate interest in ensuring that Windows users are able to acquire high quality browsers at low prices, because that would increase the demand for Microsoft's operating system. But even if achieving this objective were furthered by Microsoft's decision to offer a quality browser product, its further efforts to increase IE's share by excluding Netscape and making it more difficult for users to obtain Netscape's browser could only reduce the value of its operating system to consumers." Warren-Boulton Dir. ¶ 187.

iv. See also supra Part V.B.3.(c)(1); ¶ 156.

311.3.2. There is thus no reason for Microsoft to favor Internet Explorer over other browsers in order to increase demand for Windows.

i. Professor Fisher testified that "it may be true that having browsers widely distributed increases the demand for Windows. That doesn't mean necessarily either that that browser has to be IE, nor even to provide the integrated in the seamless experience way that I mentioned before. Nor does it imply that it is profitable for Microsoft to have done that and give it away." Fisher, 1/7/99am,

at 46:11-17.

ii. Indeed, "As an analytical matter, if browsers are a complement to operating systems such that the sale of browsers that can be used with Windows will increase demand for Windows, it should not matter who makes the complement. But Microsoft cared greatly who made the browsers used with Windows." Fisher Dir. ¶ 129.

311.3.2A. Microsoft cites no evidence that it reasonably expected that its tying or bundling of Internet Explorer with Windows at a zero royalty would increase the demand for Windows.

i. Microsoft asserts that "In light of the evidence suggesting that Internet support is a prime selling point of Windows 98 (Schmalensee ¶¶ 219, 556 (sealed); Rose ¶ 19; Feb. 19, 1999 A.M. Tr. at 49 (Rose)), there is no basis to conclude that Microsoft's integration of Internet Explorer into Windows has not had precisely the result that Microsoft anticipated." MPF ¶ 480. However, none of the cited evidence supports the notion that bundling a particular browser, Internet Explorer, rather than merely including Internet support (e.g., low-level plumbing, like TCP/IP stacks) that would support any browser in Windows was necessary to increase demand for Windows. To the contrary, the cited evidence suggests at most that the ability of a PC system (rather than the operating system itself) to access the Internet is what is important to users. Inclusion of any browser with the PC system would satisfy that demand. See supra Part V.G.6.a.; ¶ 311.3.2.

- **Schmalensee Dir. ¶ 219 simply quotes a published interview with a Compaq executive saying that Internet access has become the dominant reason users buy PCs. Neither Schmalensee there nor the article suggest that bundling the browser with the operating system is necessary to provide such access.**

- **C** **Similarly, Rose Dir. ¶ 19, and the Rose trial testimony cited above, state only that Compaq believes that the ability to access the Internet is a standard feature that users expect PCs to have. Rose, 2/19/99am, at 49:13 - 16.**

- **C** **Schmalensee Dir. ¶ 556 (sealed) simply cites a footnote listing advertisements in which the Internet features of Windows 98 are touted.**

311.3.3. But Microsoft took acts, to impede users' choice among browsers and to impede the distribution and development of other browsers, which it would not have taken were its objective increasing demand for Windows.

i. Cameron Myhrvold conceded that Microsoft imposed its exclusionary restrictions on ISPs becuase it was afraid that, if users were provided a side-by-side choice of Internet Explorer or Netscape Navigator, users would chose Navigator. Myhrvold, 2/10/99am, at 62:7 - 64:20.

ii. Paul Martiz admitted that Microsoft sought to get companies to agree not to promote Netscape's browser. Maritz, 1/26/99am, at 53:16 - 54:16.

iii. See supra Part V.A-F (detailing exclusionary practices).

iv. Professor Fisher testified that, if "Microsoft was interested in increasing the sales of Windows, "it would surely have no interest in restricting" the distribution of other browsers, "since people who wanted to use the Netscape browser with Windows would be happier" with Netscape. Fisher, 6/1/99am, at 65:24 - 66:8.

v. Professor Fisher also testified that if "Microsoft were really interested in selling Windows, it wouldn't have any interest in" imposing its shipment restrictions in ISPs, which "require that the ISP not ship more than, in this example, 15 percent of other browsers." And Microsoft "can't have any interest in doing that to protect its, quote, sales of IE, end quote, because it doesn't have any, quote, sales of IE, end quote. It's a no-revenue product." Fisher, 6/1/99am, at 66:12-25.

vi. Professor Fisher further testified: "Microsoft was preoccupied not with increasing total sales of browsers but with Microsoft's share of browser sales. Indeed, Microsoft studied, and tried to implement, ways to disable Netscape and reduce total browser sales. This conduct doesn't 'make sense from a business standpoint' if browsers are viewed as a means of increasing sales of Windows. But this conduct makes good sense if browsers are viewed as a competitive threat to Microsoft's Windows monopoly." Fisher Dir. ¶ 129 (emphasis in original).

vii. Dr. Warren-Boulton testified: "Microsoft has a legitimate interest in ensuring that Windows users are able to acquire high quality browsers at low prices, because that would increase the demand for Microsoft's operating system. But even if achieving this objective were furthered by Microsoft's decision to offer a quality browser product, its further efforts to increase IE's share by excluding Netscape and making it more difficult for users to obtain Netscape's browser could only reduce the value of its operating system to consumers." Warren-Boulton Dir. ¶¶ 187, 189.

312. Microsoft's related contention -- that its negative pricing was part of a profitable plan to distribute widely the platform-aspects of its browser, including APIs, in order to increase demand for Windows -- is also pretextual.

312.1. First, because Internet Explorer lacked APIs when Microsoft committed to giving it away forever free, this contention cannot explain Microsoft's actions.

i. Brad Chase testified, "In August 1995, Microsoft embarked on a redesign and rewrite of Internet Explorer from the ground up. Our objective was to rebuild Internet Explorer as a set of separate components, a process known as componentization." Microsoft dedicated a team of more than 100 developers to the development of this product which eventually was released as Internet Explorer 3.0. Chase Dir. ¶¶ 18-20.

ii. William Poole testified that "Microsoft began offering a 'componentized' version of its Internet Explorer technologies in August 1996 with the release of Internet Explorer 3.0." Poole Dir. ¶ 127.

312.2. Second, Microsoft spent millions developing Internet Explorer for other operating systems, where it neither exposes APIs nor increases demand for Windows 95/98, and gave those versions of Internet Explorer away for free, made it more difficult for users to employ other browsers on other operating systems, and paid users to use Internet Explorer rather than other browser on those operating systems.

i. See supra Part V.B.1.c.(1); ¶ 113.2.2 -.3.

ii. Microsoft executive John Messerly wrote to Ben Slivka in June 1995 that "the importance of your browser achieving dominance will in places override other (in this case systems) interests. Systems want to show that Windows is as good if not better Multimedia platform than Mac . . . In some respects, having an Ohare broswer [sic] that screams as fast on the Mac as it does on Windows works against that goal. But let's not loose [sic] our sense of proportion about what this downside cost is though. It's not like netscape won't be making their mac client as fast as possible, or like other groups in MS aren't making their products as fast as they can possibly be on Mac. The benefits of winning the browser war outweigh the minor costs of making the Mac version as good as and in lock step with the rollout schedule of the windows version." GX 332.

iii. As Professor Fisher testified: "Whatever the relevance of Microsoft's arguments about why it wanted to make Internet Explorer available to sell more copies of Windows, those arguments cannot apply to Microsoft's efforts to force Apple to distribute Internet Explorer." Fisher Dir. ¶137. "Microsoft devoted substantial time, effort, and money to developing and distributing a version of IE for Apple computers. Microsoft gets no money from increasing sales of Apple's operating system; indeed, since Apple offers the main alternative to a PC using Windows, promoting complements to Apple that increase Apple's attractiveness to users reduces sales of Windows." Fisher Dir. ¶ 129.

312.3. Third, Microsoft could have included the APIs in Window itself and sold the browser at a positive price.

i. Professor Fisher testified, based on evidence that the "consumer gets the same benefits if it acquires" the browser and operating system separately and combines them, that "there is no reason why Microsoft shouldn't offer them typically separately throughout and let consumers decide, if those are really good benefits." Fisher, 6/1/99am, at 43:15 - 44:12; see also Fisher, 6/1/99am, at 42:1-6 (“There appears to be no particular reason why Microsoft could not have offered its browser, both together with the operating system and separately, and offered the operating system separately, all of these things at different charges. And because consumers wanted it, that would have been a profitable thing to do.”).

312.4. Fourth, Microsoft’s free provision of Internet Explorer cannot be explained as an effort to “stabilize” APIs because Microsoft continues to destabilize the APIs through its frequent Internet Explorer and Windows updates.

i. Professor Fisher testified that “it’s not obvious that” the “API’s have to be Microsoft’s API’s for there to be a stable set of API’s offered to Developers” and “Microsoft’s API’s are not, in fact stable. They change. And ISV’s have to keep embedding pieces of the appropriate APIs into their own software in shipping it out.” Fisher, 6/3/99am, at 22:3-14.

ii. See supra Part V.B.3.d.(2); ¶ 164.4 (Microsoft fragments its platform by updating Internet Explorer APIs).

b. Microsoft’s argument that ancillary revenues explain its better-than-free pricing of Internet Explorer is pretextual

313. Microsoft also argued that it expected to recoup its browser-related expenditures from “ancillary revenues,” such as revenue from search-engines (Maritz Dir. ¶ 306; see also Schmalensee Dir. ¶ 556). This argument is implausible.

313.1. There is no contemporaneous evidence to support this argument.

i. Professor Fisher testified: “Microsoft’s document do not say, ‘we’re doing this with Internet Explorer because Internet Explorer is going to bring in a lot of money.’ In fact, contemporaneous documents do not suggest that Microsoft cared at all about -- and some of its actions also confirm this -- that Microsoft cared at all about the ancillary revenues that might” be “derived from giving way Internet Explorer.” Rather, “Microsoft’s documents are full of statements” that “‘This is a no revenue product, but you should care about it just as much as does Bill Gates. Without winning the browser war, we lose.’” Fisher, 6/1/99am, at 40:7-25; see also Fisher Dir. ¶ 130, at (f) (“Microsoft's contemporaneous documents make clear that the company's zero (or negative) price for its browser was not considered a way to earn competitive ancillary revenues but a way to prevent potential competition from alternative platforms.”); Fisher, 1/7/99am, at 17:6-9 (“I do know there is not a hint in the contemporaneous Microsoft documents that that's what they were thinking about in terms of these revenues. That appears to have been invented in the middle of this trial.”); Fisher, 1/7/99am, at 17:13-18 (“So far as I know, there was, up to the beginning of this trial--I may be wrong about this--but so far as I know, there are no Microsoft documents that say we're doing this in order to get the alternative--the ancillary revenues. The documents are full of statements about we're doing it to protect the desktop.”).

ii. Professor Fisher further testified that, “in terms of what Microsoft thought it was doing -- if Microsoft was doing this stuff with the browser because of the ancillary revenues, you would expect there to be contemporaneous documents or business plans that show that’s why they’re doing it. They [sic] wasn’t anything like that, so far as I know.” Fisher, 6/1/99am, at 64:2-8; see also Fisher, 6/1/99am, at 68:10-13 (“If Microsoft was undertaking” its “campaign to have ancillary revenues, you would expect them to be able to produce some records that show that the ancillary revenues were going to be sufficient to justify the costs.”).

iii. Dr. Warren-Boulton testified that calculations made today, rather than when Microsoft made its business decisions, are not relevant: “if Microsoft performed such a calculation today and determined that it earned substantial ancillary revenues from increasing its browser usage share, that result would not be meaningful unless it could be shown to provide a reliable guide to what reasonably could have been anticipated by Microsoft at the time the decision was made.” Warren-Boulton Dir., ¶ 193.

313.2. Microsoft’s actual conduct is inconsistent with that its ancillary revenue explanation.

313.2.1 First, Microsoft declined to take advantage of significant browser-related ancillary revenue opportunities.

i. Professor Fisher testified: “Microsoft, in doing what it does with its browser, from time to time took actions which, in fact, gave up part of the ancillary revenues.” Fisher, 6/1/99am, at 64:9-11.

313.2.2. Microsoft allows other firms to collect ancillary revenues derived from the Internet Explorer start page.

i. If Microsoft were really in the business for ancillary revenues, Professor Fisher testified, it would not permit people to change the default start page. Fisher, 1/12/99am, at 35:21 - 36:21.

ii. Joachim Kempin testified that, although Microsoft's OPK prohibits OEMs from changing the Internet Explorer "start page," he "understands" that this requirement "is not enforced." Kempin, 2/25/99pm, at 92:7 - 94:23; GX 1201. In fact, he testified, "I know that one OEM, in particular, has asked me if they could" change the start page, "and I said yes . . . . I think that was Dell." Kempin, 2/25/99pm, at 94:9-23.

313.2.2.1. Microsoft allows producers of browser shells and (ignoring its own licensing terms) OEMs to collect ancillary revenues that Microsoft would otherwise derive from the Internet Explorer start-page.

i. Microsoft permits OEMs to install "shell browsers," such as Encompass, which are not actually browsers but rather shells that sit on top of the Internet Explorer browser and present a different user interface. These shells rely on the underlying Internet Explorer technology. See supra Part V.C.1.b.(2); ¶ 185.2.1. The shell displays the OEM's own brand, not Microsoft's, and can be configured to point to any start page of the OEM's choosing. The OEM and its shell-browser partner keep any revenue it earns from selling advertising on the start page. Warren-Boulton, 11/30/98am, at 72:3 - 74:21.

ii. Kempin's videotape demonstrated the Encompass browser shell, which is built "on top" of Internet Explorer but is customizable by third parties in ways that allow them, rather than Microsoft, to capture significant ancillary revenues. DX 2163.

iii. Microsoft represented, during the cross-examination of Mr.

Harris, that Dell is allowed to set Excite as the default browser for Dell customers who connect to the Internet through Dell's new Connect Direct [sic; actual transcript reads Correct Direct], and that Compaq has "exactly the same deal with Yahoo." Harris, 1/5/98am, at 25:18-25; see also DX 1842 (HP ships both Internet Explorer and Encompass shell).

iv. Dr. Warren-Boulton testified that the Encompass browser shell shows that: "What Microsoft is trying to do here is to increase the percentage of IE technologies based" on "the IE browsers, not, as is clear," to "make a lot of money off the Internet in the sense of advertising." Warren-Boulton, 11/30/98am, at 79:22 - 80:19. He further explained that "the question is at the time that they were making these decisions, why is it that they want to increase browser share. And I think, that, you know, it speaks exactly to the point that you're making. Microsoft cares a great deal about having people use browsers that use IE technologies, even though, as you're pointing out, there is no direct revenue to Microsoft from advertising or other sources." Warren-Boulton, 11/30/98am, at 80:20 - 81:4.

313.2.2.2. Microsoft permits browser licensees, such as ISPs, OLSs, and ICPs, to change the Internet Explorer start-page.

i. According to the testimony of Cameron Myrhvold, Microsoft's Internet Explorer Administration Kit enabled ISPs to preset the default homepage so that customers would be taken to the ISP's web site whenever they logged onto the Internet. Myrhvold Dir. ¶ 33.

ii. Professor Fisher testified that the ancillary revenues Microsoft sacrificed included permitting "OLS's to take their subscribers directly to the OLS's home page and not to Microsoft's home page. That gives up some of the" ancillary "revenues." Fisher, 6/1/99am, at 64:9-19; see also Fisher, 6/1/99am, at 69:11-18 (giving the example of AOL).

iii. On cross examination of William Harris of Intuit, Microsoft represented through its questions that Microsoft is taking steps to make it easier for consumers to change their browser home page. Microsoft's lawyer asked whether Harris is aware that Internet Explorer 5.0 "will enable web sites to display a button that says "ake this page your browser default start page," and all you have to do is click on that button to change the home page automatically?". Harris, 1/5/99am, at 27:22 - 28:2.

iv. Microsoft's William Poole, who was "attempting to be helpful," told Mr. Harris at the break during his cross examination that in Internet Explorer 5.0, Microsoft "was making it easier to change the default browser page and that, in fact, that was their strategy and intent across many different venues with ISPs, with OEMs, etc., making it easier for them to set defaults rather than Microsoft." Harris, 1/5/99am, at 42:5 - 43:7.

313.2.3. Microsoft's indifference to collecting these ancillary revenues stands in stark contrast to the practice of other firms which, unlike Microsoft, have no incentive to sacrifice such revenues in order to preserve monopoly power.

i. Dr. Warren-Boulton testified that the contrast between Microsoft's incentives to sacrifice ancillary revenues by allowing shells to be built on its browser and Netscape's incentives instead to try to collect any available revenue from its browser "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 is trying to do in the browser market, which is to control the technologies." Warren-Boulton, 12/1/98am, at 13:12 - 14:11.

313.3. Second, the ancillary revenues arguably associated with the zero price for Internet Explorer are insubstantial.

313.3.1. Revenues from search engine contracts and the like are not large enough to cover Microsoft's browser-related expenditures, nor are they appropriately attributed wholly to Microsoft's browser; they certainly are not attributable to the free pricing of Microsoft's browser.

i. Microsoft represented, during Professor Fisher's cross-examination, that Microsoft receives $15 million a year from each of two search engines, Altavista and Lycos, just for placing the search engines on the "MSN web search" menu of MSN.com, MSN's start page. Fisher, 1/7/99am, at 50:18 - 52:18. But, as Professor Fisher testified, such revenues should not be attributed to Internet Explorer because Microsoft earns them for placement on the MSN start page. Fisher, 1/7/99am, at 53:8-19.

ii. Even if one looked at the ancillary revenues that Microsoft receives today from the browser, one must only look at those revenues that Microsoft makes because of the "better than free" pricing of the browser. Professor Fisher noted that "the real question is . . . was there value to Microsoft . . . beyond the value that would have occurred had they charged separately" for the browser "and then allowed Netscape to be distributed more widely." Although "there may be some" value, "I don't think there is nearly enough to account for what happened." Fisher, 6/3/99am, at 25:18 - 26:1.

iii. Barksdale testified that Netscape makes money from portal revenues, but that doing so does not require giving away the client: "But we were doing that before. I mean, we would have that revenue anyway." Barksdale, 10/27/98pm, at 23:23-24.

iv. Furthermore, Barksdale testified, the ancillary revenues he hopes "offset some of that cost" of the browser, but relying on those to cover the entire costs is not "economically viable. And by the way, you would never start a business with that business plan, I don't think." Barksdale, 10/27/98pm, at 23:12 - 24:4.

313.3.2. There is no evidence that other ancillary revenues, such as selling more servers or advertising for other products, could cover Microsoft's immense browser-related expenditures.

i. Professor Fisher testified: "There is no reason to believe and some reason not to believe-- and considerable reason not to believe -- that" the ancillary revenues Microsoft obtains from its negative pricing of the browser can "possibly lead to a recoupment of the amount of money that as spent on the development of Internet Explorer." Fisher, 6/1/99am, at 65:10-14.

313.4. Third, the examples of firms giving away products for free, to which Microsoft points **(MPF ¶¶ 485-93)**, cannot explain Microsoft's very expensive effort to build a dominant browser share.

i. Professor Fisher testified: "It is sometimes the case that, for various reasons -- sometimes it's introductory offers; sometimes it's for reasons of expanding the market; sometimes because of the selling of ancillary products -- that companies will give away or sell very cheaply things which lead to those ends. And if that's all that Microsoft had done, we wouldn't be here today. But that's not what happened." Fisher, 1/7/99am, at 44:23 - 45:5.

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313.4.1. Most of the examples Microsoft cites (Maritz Dir. ¶¶ 278-306; Maritz ¶ 313) are very different from its commitment to give away Internet Explorer "forever free" because, among other things, they are associated with specific, anticipated other revenues.

313.4.1.1. <u>Apple</u>. Apple charged for advanced versions of QuickTime, something Microsoft does not do with IE.

i. Apple's Avadis Tevanian testified that, although Apple gives its basic version of QuickTime away for free, it charges $29.99 for its advanced version, QuickTime 3.0 Pro. Tevanian, 11/5/98am, at 6:16 - 7:7.

313.4.1.2. <u>Intel</u>. Intel in some instances licenses its software for a fee, but in other instances gives it away. There is no evidence that Intel's modest expenditures on free software could be recouped only by preserving monopoly power.

i. Intel, although it gave away much of its software in order to raise "the capability of the overall personal computer platform," nonetheless "in some cases . . . did try to license" its "software for fees." McGeady, 11/12/98am, at 34:18 - 35:13.

313.4.1.3. <u>Adobe</u>. Adobe gives away its "viewer" for free in order to charge for content-creation tools.

i. Professor Fisher testified that, even though it may make sense for Adobe to give away its viewer so it can make money selling the authoring software, that is not true of Microsoft's effort to gain browser usage share. Fisher, 1/7/99am, at 42:25 - 43:14.

313.4.1.4. AOL. Although AOL gives away its access software for free, it makes money on subscriptions (the only purpose of the access software is to access AOL's service).

i. Professor Fisher testified that AOL gave away its Booklink software to subscribers as part of the software that enabled them to take advantage of the AOL service. AOL then earned subscription revenue from the AOL service. Fisher, 1/6/99pm, at 10:24 - 11:23.

313.4.2. The fact that Netscape decided to reduce the price of its browser to zero in response to Microsoft's zero price provides no basis to infer that Microsoft's zero price is profitable.

313.4.2.1. Microsoft's zero price was established after Netscape had already incurred the costs of developing its browser; and the issue Netscape faced at that point was simply how it could cover its avoidable, future costs. Microsoft, by contrast, sunk massive costs in developing, promoting, and distributing its browser after it decided to make it "free forever."

i. See supra V.G.2.; ¶ 299 (describing MS's huge expenditure).

313.4.2.1A. Whether AOL may now find it necessary to continue to offer Netscape for free, or even for better than free (MPF ¶¶ 492-493), in the face of Microsoft's ongoing zero price does not suggest that Microsoft's quite-different predatory conduct is somehow legitimate.

i. **See supra Part V.G.1;** ¶ 298.3**.**

313.4.2.2. Netscape (and now AOL) also obtains substantial portal revenues and, thus, unlike Microsoft -- which surrenders such portal revenues by permitting the start page to be changed -- can give its browser away and still recover its future costs.

i. Although Dean Schmalensee testified that the portal revenues described in documents concerning the AOL/Netscape merger show a profitable plan to distribute "browsing software at a substantial negative price" because of portal revenues (Schmalensee, 6/21/99pm, at 51:8-21, 53:4 - 54:19, 56:11-24, 75:12-23; DX 2518), he ignored that

ii. Colburn explained that "our [AOL's] business model is based on a premise where you want to keep people coming to the portal, and once they're there, having them stay there, because that's how you can generate an economic model." Colburn, 6/14/99pm, at 27:13-16.

c. Dean Schmalensee's argument that predation is implausible is flawed

(1) Dean Schmalensee greatly underestimates the costs, and overstates the legitimate benefits, of Microsoft's predatory strategy

314. Dean Schmalensee argued that Microsoft could not possibly have engaged in predation because only a modest increase in either the price for or sales of Windows would make its actions profitable. Schmalensee, 6/21/99pm, at 56:25 - 62:15; DX 2763; DX 2764; Maritz Dir. ¶ 36; **see also MPF ¶¶ 473-475**. This analysis is flawed.

314.1. First, Dean Schmalensee's analysis looks to benefits that occurred after the fact; but predation analysis is not properly based on hindsight.

i. Dean Schmalensee conceded that a predation analysis properly examines expected revenues and costs yet admitted that he did not "make an analysis of what revenues, if any, Microsoft expected to receive from or as a result of the browser at the time that Microsoft was developing its Internet Explorer browsers." Schmalensee, 6/24/99pm, at 15:5-19.

ii. Dr. Warren-Boulton testified: "I have seen no documents indicating that Microsoft ever performed such a calculation at the time these decisions were made. (Indeed, if Microsoft performed such a calculation today and determined that it earned substantial ancillary revenues from increasing its browser usage share, that result would not be meaningful unless it could be shown to provide a reliable guide to what reasonably could have been anticipated by Microsoft at the time of the decision was made.)." Warren-Boulton Dir. ¶ 193.

iii. Professor Fisher testified that "what matters is what is expected (or can reasonably be expected) at the time the action in question is taken." Fisher Dir. ¶ 49.

314.2. Second, Dean Schmalensee drastically understates the costs of Microsoft's predatory campaign.

i. Dean Schmalensee took as the cost to Microsoft of Internet Explorer the development costs of $100 million a year. Schmalensee, 6/21/99pm, at 59:18 - 60:2; Schmalensee, 6/24/99pm, at 16:24 - 17:8.

ii. But as explained, the actual costs of the predatory campaign -- including the amounts Microsoft paid third parties to distribute its browser and not to distribute other browsers -- were substantially larger. See supra V.G.2.; ¶ 299.4.

iii. Dean Schmalensee conceded that he did not seek to account for the costs of marketing Internet Explorer or the opportunity costs Microsoft incurred to increase its browser share. Schmalensee, 6/24/99pm, at 17:13 - 18:16. Nor did Dean Schmalensee take into account assets Microsoft bartered for exclusion, such as desktop placement (Schmalensee, 6/24/99pm, at 26:9 - 32:14) even though he conceded that marketing costs should be taken into account. Schmalensee, 6/24/99pm, at 17:13 - 18:24.

314.3. Third, Dean Schmalensee overstates the benefits because he includes benefits Microsoft would have obtained even if it did not set a zero price for Internet Explorer.

i. Dean Schmalensee points to all the ways Microsoft has assertedly "improved" Windows, including adding Internet Explorer (Schmalensee, 6/21/99pm, at 62:6 - 69:22; DX 2764; Schmalensee, 6/22/99pm, at 7:20 - 8:15). But he did not analyze how much Microsoft would still have "grow[n] the Windows business" (Schmalensee, 6/21/99pm, at 69:12-17) had it nonetheless charged for Internet Explorer at a positive price.

ii. Professor Fisher testified that the only revenues that are properly taken into account as benefits to Microsoft from its zero price are those Microsoft could not have obtained by charging a positive price: "In figuring out whether or not Microsoft's actions were predatory, one should certainly take account of the ancillary revenues which it reasonably expected to earn as a result of those actions. But you don't get to count all those revenues as though they wouldn't be there had Microsoft taken some other action, because if Microsoft had sold its browser at a separately stated price, there would still have been some amount of those ancillary revenues which it would then have achieved. And those have to be offset against the ones that are achieved by giving it away. You also, of course, have to balance that against what it would then have received for the browser had it sold." Fisher, 1/12/99am, at 37:22 - 38:8.

314.4. Fourth, Dean Schmalensee's refusal to examine why Microsoft actually undertook its better than free pricing (Schmalensee Dir. ¶¶ 337-338) renders his analysis unreliable.

i. Dean Schmalensee previously endorsed "only one economically defensible general policy choice: Scherer's proposal that courts follow a rule-of-reason approach and perform a thorough examination of the factual circumstances accompanying the monopolist's alleged predatory behavior, how the monopolist's officials perceive the probable effects of its behavior (i.e., Intent), and the structural consequence actually flowing from the behavior." GX 2334, at 1028.

ii. Dean Schmalensee sought to distance himself from this article by asserting that he is "less comfortable" inferring intent from behavior except "when . . . one has a smoking gun -- or a warm smoking gun." Schmalensee, 6/24/99pm, at 43:14-24. But, he conceded, "the better the intent evidence, the stronger the weight it ought to have." Schmalensee, 6/24/99pm, at 44:23-25.

iii. Despite this concession, Dean Schmalensee wholly ignored in his analysis the contemporaneous statements of Microsoft executives that they were giving away the browser, not to expand demand for Windows or to garner ancillary revenues, but rather for the specific purpose of blunting the browser threat to its operating system monopoly. See supra V.G.4.; ¶ 301.

314A. Thus, while Microsoft contends that Professor Fisher "Performed no analysis" to support his conclusions, and that "Schmalensee considered the questions Fisher ignored" (MPF ¶¶ 468, 473), the facts show precisely the opposite.

(2) Dean Schmalensee is wrong that successful predation required eliminating Netscape

315. Dean Schmalensee argued that no predation has taken place because Netscape has not been eliminated as an important browser producer (Schmalensee, 6/21/99pm, at 32:4 - 33:21); but this testimony is misconceived because eliminating the threat Netscape posed to Microsoft's operating system monopoly required only preventing Netscape from obtaining a dominant browser share, not driving it from the browser market altogether.

i. See infra Part VII.A.1.; ¶ 359.

315A. Accordingly, Microsoft's argument that it has not eliminated Netscape's ability to provide "a viable 'platform'" (MPF ¶¶ 494-497; see also ¶ 470), misses the point.

i. Microsoft can and did maintain its monopoly not by preventing Netscape (or other browsers) from offering a platform, but rather by preventing such a platform from gaining a sufficient share of users to constitute for developers a genuine alternative to Windows. See infra Part VII.A; ¶¶ 358-359, 371.

ii. Maritz testified that browser share is the key because "the more that your platform gets used versus the competitor's platform, it stands to reason that you will be better off." Maritz, 1/25/99pm, at 32:4-10; see also infra Part

VII.A.1; ¶ 359.4**; Part VII.B.3.c;** ¶ 388**. Microsoft acknowledges that Netscape's share is dropping and that AOL, the recent purchaser of Netscape, believes Netscape's share has been dropping. MPF ¶¶ 261, 275; see also infra Part VII.C.2;** ¶ 395**. Microsoft's assertion that the number of Netscape's users "will swell" in the future (MPF ¶ 497) is thus immaterial.**

(3) Dean Schmalensee is wrong that predation is implausible on the ground that AOL "holds the key" to the browser market

316. Dean Schmalensee argued that it is implausible that Microsoft engaged in predation because AOL could, anytime it chose, confer on Netscape a large share in browsers. Schmalensee, 6/21/99pm, at 88:9-11 (testifying that "AOL holds the key to browser share"); see also Schmalensee, 6/21/99pm, at 85:12-17; Schmalensee Dir. ¶¶ 541-549; **see also MPF ¶¶ 498-99**). This argument is unsound.

316.1. First, Microsoft successfully predated in part because it paid AOL to distribute Internet Explorer instead of Netscape. Microsoft's and AOL's incentives to continue a similar arrangement in the future are not diminished by AOL's acquisition of Netscape.

i. Professor Fisher testified that "if, indeed, there is any effect of the merger" it is "that Microsoft will have to give up some of its monopoly rents to AOL." Fisher, 6/3/99am, at 20:19-24.

ii. See infra VII.C.2; ¶ 395.

316.2. Second, Microsoft's demonstrated ability to engage in predatory conduct to crush incipient platform threats in any event makes unlikely the possibility AOL will cease distributing Internet Explorer in order to challenge Microsoft's operating system monopoly.

i. See infra Part VII.C.2.; ¶ 394.1.

316.3. In any event, as Microsoft itself recognizes, even if AOL's incentives

were otherwise, AOL will continue to be bound by its agreement with Microsoft to use Internet Explorer until at least January 1, 2001. MPF ¶ 804; Chase Dir. ¶ 76**.**

(4) Dean Schmalensee is wrong that predation is implausible because other threats to Microsoft's operating system monopoly might exist or arise

317. Dean Schmalensee's testimony that predation is implausible because, even if Microsoft successfully eliminated the browser threat, other threats would prevent it from exercising monopoly power (Schmalensee, 6/21/99pm, at 86:7-17; Schmalensee Dir. ¶ 553), is also flawed.

317.1. First, Microsoft's operating system monopoly is protected by high entry barriers, and the Netscape browser threat presented an unusual risk to Microsoft's position. The other alleged threats are less serious today and may depend on the success of non-Microsoft browsers to develop.

i. See supra Part III.D.; ¶¶ 60-62.

317.2. Second, Microsoft recoups the costs of its predatory conduct by reducing the probability that Windows will be displaced and thus increasing the value of its monopoly; that recoupment occurs from the outset of the predatory campaign.

i. Professor Fisher testified: "Microsoft is now . . . recouping in the form of . . . increasing freedom from the threat of losing its monopoly power. . . . It's financial recoupment will occur from preserving the returns to the monopoly power in operating system, returns that might have been dissipated had it not acted in the way in which it did." Fisher, 1/12/99pm, at 31:15 - 32:7.

ii. Professor Fisher further testified that "of course, one cannot know with any kind of certainty when or even whether the threats from Java and the browser would have led to a breakdown of the applications barrier to entry, and, therefore, to more competition in operating systems. And maybe the answer is never. But Microsoft didn't give it a chance to try. And it's managed . . . to preserve its monopoly profits into the foreseeable future." Fisher, 1/12/99am, at 32:8-15.

iii. Dean Schmalensee's own charts show that Microsoft's continued dominance of the operating system market for even a short period of time as a result of its anticompetitive conduct would result in immense profits. DX 2763; Schmalensee, 6/24/99pm, at 22:16 - 24:19 (conceding that Microsoft could recoup the costs of a $600 million campaign through a $9 increase in the price of Windows).

317.3. Third, Microsoft's predatory conduct has deterred, and will continue to deter, other threats from arising.

i. See infra Part VII.D.2.; ¶¶ 402-403.

317A. Microsoft's arguments on recoupment are misplaced. Microsoft creates and then knocks down a straw man that is not based on the evidence. Microsoft argues that recoupment is implausible because "plaintiffs offered no evidence that Microsoft believed (or could reasonably have believed) that it could raise significantly the price of Windows." MPF ¶¶ 500-503. But the evidence shows that Microsoft recoups its huge browser development and promotion investment by preserving its Windows monopoly -- that is, by increasing the expected duration of its monopoly power and desktop dominance, and thus the value of the company -- regardless whether it leads to higher unit prices for Windows.

i. Fisher, 1/12/99am, at 40:25 - 41:16**;** Fisher Dir. ¶¶ 124-128**,** 241**.**

317A.1 Microsoft's criticism that Professor Fisher offered a "theory of psychic recoupment . . . wholly foreign to predation analysis" (MPF ¶ 503) ignores the evidence: Microsoft set a better-than-free price for one product, Internet Explorer, with the expectation and result of protecting its existing monopoly -- and monopoly returns -- on another product,

Windows.

i. **<u>See</u> <u>supra</u> Part V.G.4; ¶¶** 301-305**, Part V.G.5.b; ¶** 309**, Part V.G.6.c.(1);** ¶ 314.4**.**

ii. **Microsoft's records reveal that it planned to profit from its predatory practices not necessarily by raising the price of Windows, but rather by preventing Netscape and Java from eroding its existing monopoly profits from Windows at the existing price. As Chase wrote in 1997, "IE share is critical. Without it, we lose the desktop, which translates to Windows and Office revenue <u>over time</u>."** GX 59 **(emphasis added); <u>see also</u> supra Part V.G.4; ¶¶** 301**,** 302**.**

317A.2. Microsoft's suggestion that recoupment cannot occur during the course of a predatory campaign (MPF ¶ 503) is wrong.

i. **Professor Fisher explained throughout his testimony that Microsoft recoups from its expenditures on Internet Explorer by blunting Netscape's threat to Windows, thereby increasing the expected duration, and thus the present value, of its monopoly. The recoupment occurs both at the time of the conduct and in the future. <u>See</u>, <u>e.g.</u>, Fisher Dir. ¶¶ 124-128, 241; Fisher, 1/12/99am, at 40:25 - 41:16; Fisher, 6/1/99am, at 39:14 - 40:25, 68:18 - 69:10.**

ii. **Microsoft cites only its economist, Dean Schmalensee, in support of the proposition that recoupment in the same time period as the predatory conduct "cannot be considered predatory." MPF ¶¶ 503. In that testimony, however, Schmalensee said only that he did not know of other cases or other situations in which such recoupment had been discussed; he did not rebut Fisher's testimony that such recoupment was logically and economically sound and consistent with the facts of this case.**

317A.3. Microsoft argues that Professor Fisher's testimony that the "browser war" was substantially over by early to mid-1998 means that, under his theory of Microsoft's predatory preservation of its operating system monopoly, Microsoft should have already raised the price of Windows 98. MPF ¶ 502. This argument ignores both facts and logic.

i. The argument ignores the evidence that Microsoft intended and achieved recoupment through protection of its existing monopoly returns. See supra Part G.6.c.(4).; ¶ 317.1.

ii. In any event, Windows 98 was released in June 1998 (MPF ¶ 502), after the present lawsuit was filed but before it went to trial. It strains credulity to suggest that, even if Microsoft otherwise intended to raise the price of Windows 98 to recoup, it would do so during the litigation.

iii. Further, Microsoft's argument ignores simple facts about timing, and so could not be supported by the evidence even if it were logically sound. The testimony by Professor Fisher that Microsoft cites in support of its contention that it has not raised price since the June 1998 release of Windows 98 addressed only OEM contracts signed before mid-1998 and OEM pricing data from before October 1998. MPF ¶ 502 (citing Fisher, 1/12/99pm (sealed session), at 51-59).

iv. Microsoft's argument is also flawed as a matter of logic. As both Fisher and Schmalensee testified, Microsoft is mindful of many factors when it chooses the profit-maximizing price of Windows, such as its expectations that its long-term profit interests are best served by, for example, promoting the widespread adoption of its new technologies or inducing OEMs to adopt new hardware technologies. See supra Part II.D.3.; ¶ 49.3.1. It would be illogical to conclude, from the observation that Microsoft did not raise the price of Windows at a particular moment, that Microsoft's monopoly position was not strengthened by elimination of the browser threat; other, unrelated factors could have influenced the choice of price at that particular time.