

C. AOL's acquisition of Netscape will not undo the harm to competition caused by Microsoft's predatory and anticompetitive conduct

392. The acquisition of Netscape by America Online in November 1998 will not eliminate the competitive harm caused by Microsoft's course of conduct.

1. AOL acquired Netscape for reasons other than its browser

393. Rather than demonstrating that the Netscape/AOL combination is a robust platform threat, AOL's acquisition of Netscape itself evidences the harm to Netscape's browser business caused by Microsoft's predatory campaign. Netscape was acquired because it had been damaged by Microsoft's campaign.

393.1. AOL acquired Netscape despite the browser business, not because of it.

- i. Steve Case, AOL's CEO and Chairman, testified that AOL "did not buy Netscape because of the browser business. Indeed, we bought Netscape, to some extent, despite the browser business." Case Dep. (played 6/4/99am), at 46:7-12.
- ii. Barry Schuler, AOL's President of Interactive Services, testified that Netscape's browser business "wasn't something that we were really focused on. The browser market share played a very small role in our overall evaluation." Schuler Dep., 5/5/98, at 81:4-8 (DX 2810).
- iii. Schuler further testified: "I was relatively lukewarm about the idea" of acquiring Netscape. "I felt that there was a part of their business which was compatible with ours and another part that was outside of our core competency. And I felt that the browser part of their business as a business was dead." Schuler Dep., 5/5/98, at 31:12 - 32:6 (DX 2810).

393.1.1. AOL believed that Netscape's browser business was declining, and likely to decline further, as a result of Microsoft's anticompetitive conduct.

- i. Case said that AOL "believed that the Netscape browser business that was flourishing three or four years ago was in a state of significant decline." Case Dep., (played 6/4/99am), at 46:7 - 47:6; Case Dep., (played 6/4/99am), at 46:13-16.

- ii. Schuler testified that “we knew we were in a market where browser share was declining.” Schuler Dep., (played 6/22/99am), at 11:14 - 12:4; Schuler Dep., 5/5/98, at 54:14-17 (DX 2810); Schuler Dep., 5/5/98, at 54:20 - 55:7 (DX 2810).
- iii. According to an internal AOL analysis, Netscape’s “share has declined over the past two years from 80 percent, and is expected to decline further to approximately 35 percent to 50 percent over the coming two years in the face of Microsoft browser being increasingly tightly integrated with Windows 98.” DX 2518, at AOL NO150025; Schmalensee, 6/24/99am, at 72:7-15.

393.1.2. AOL believed that the weakened state of Netscape’s browser significantly increased the transaction’s risk.

- i. Steve Case testified that AOL knew that Netscape’s “browser market share would likely to decline. One of the concerns we had in pursuing the” Netscape acquisition “was, to the extent” Netscape’s browser market share “was declining on our watch, it might reflect poorly on AOL, and that bothered us. But we thought that on balance, inheriting that risk, since the browser was not in and of itself a business, and focusing people’s attention on the businesses we care about, which were portals and E-commerce, and the other assets we cared about, which was the brand name and the team, on balance it made sense for us to pursue this acquisition.” Case Dep., (played 6/4/99am), at 46:7 - 47:6.
- ii. Barry Schuler testified that “We didn’t want the metrics of the America Online business to be measured in terms of browser share from a Wall Street market perception point of view.” Schuler Dep., (played 6/22/99am), at 11:14 - 12:4.
- iii. As an internal AOL document on the AOL/Netscape transaction points out: “Making the situation even more difficult, outside parties are going to highlight the [AOL] versus Microsoft scenario repeatedly, no matter what we say or do. The clearest way to counterbalance this negative drumbeat would be to announce, right before going public with the [Netscape] acquisition that, [AOL] has renewed its Internet Explorer agreement through August 2000 and, if possible, renegotiate now beyond 2000 (which would permit [AOL] to retain its presence on the Windows 95 and Windows 98 operating systems.” DX 2445 (sealed); see also

Colburn, 6/22/99am, at 7:22 - 8:6.

393.2. AOL instead purchased Netscape because of Netscape's portal, server and e-commerce products.

- i. Case testified that Netscape's value to AOL was that AOL was "largely missing in action in the portal space" and that, "in evaluating the various alternatives building it ourselves, acquiring something, we concluded that Netcenter was the best option, particularly given the price." Case Dep., (played 6/4/99am), at 45:5-25.
- ii. In an internal AOL e-mail, Case wrote:

GX 2112 (sealed); Fisher,
6/4/99am, 47:17 - 48:6 (testifying that GX 2112 "confirms the proposition
that the purchase of Netscape was not because of the browser.").
- iii. Schuler testified that the portal and e-commerce aspects of the transaction "were the components of the business that were of value to America Online." Schuler Dep., 5/5/98, at 51:24 - 52:5 (DX 2810); Schuler further testified that: "The transaction was analyzed really in two components, and that was the portal business and their enterprise E-commerce business." Schuler Dep., 5/5/98, at 19:4-8 (DX 2810).
- iv. David Colburn also testified: "I think we had basic reasons why we did the deal, being the portal, the e-commerce, capturing the Netscape name and the Netscape people." Colburn, 6/14/99pm, 7:22 - 8:6; Colburn, 6/14/99pm, at 9:5-20.
- v. An internal AOL document reads: "This acquisition and alliance is about using Netscape's portal and e-commerce development businesses and Sun's hardware, platforms and distribution channels to build on America Online's portal strategy and take e-commerce to the next level." DX 2522; 6/22/99am, at 6:2-17.

393.3. To the extent AOL valued the browser, it was only as a means of feeding traffic to Netscape's portal site, not for its potential to develop into an alternative platform.

- i. Schuler also testified that the importance of Netscape's browser to the acquisition related to Netscape's ability to transform its "decimated" browser business into an Internet portal business. Schuler described

Netscape's transformation of its browser into a "client" by linking the browser to Netcenter, its Internet portal, as a "strategy that Netscape . . . pursued once their standalone browser business was no longer a viable P&L product line." Schuler Dep., 5/5/98, at 52:14-19 (DX 2810).

- ii Colburn testified that acquisition of Netscape does give AOL "an additional client to use and to attach to the portal." Colburn, 6/14/99pm, 36:7-20. He also testified that "Part of the interest in the portal was that it was tied to the browser client, and that helped drive traffic and things like that." Colburn, 6/14/99pm, at 7:22 - 8:6; see also Colburn, 6/14/99pm, at 9:5-20.
- iii. Professor Fisher concluded that the transaction was "certainly not about . . . AOL wishing to use the Netscape browser instead of the Microsoft browser." Fisher, 6/2/99pm, at 44:16-22.

393.4. Relative to what it would have cost to acquire other firms with significant Internet portals, AOL was able to acquire Netscape cheaply.

- i. Case testified that portal "Companies like Yahoo and others were doing quite well in that space. And we thought having a different brand focused on that particular segment was important. And in evaluating the various alternatives building it ourselves, acquiring something, we concluded that Netcenter was the best option, particularly given the price." Case Dep., (played 6/4/99am), at 45:5-25.
 - ii. Professor Fisher concluded, after comparing the price AOL paid for Netscape to the prices paid in two other unrelated transactions in which firms with portals were acquired: "If one looks at those transactions and then tries to measure the importance of the portal by various measures, sort of how much advertising really was involved by using the portal and so forth, one comes to the conclusion -- and does the same for Netscape -- one comes to the conclusion that Netscape was acquired, if anything, cheaply." Fisher, 06/01/99am, at 65:13-19.
- 2. AOL will not, in the wake of Microsoft's predatory campaign, seek to resuscitate the browser threat; indeed, Microsoft remains likely to achieve dominance in browsers**

394. AOL will not seek to revive the platform threat that Netscape's browser once presented and that Microsoft went to great lengths to crush.

394.1. First, Microsoft's predatory campaign against Netscape has signaled to AOL (and other would-be browser rivals) that Microsoft will engage in anticompetitive actions to prevent the browser threat from arising again and thereby deters AOL and others from seeking to revive the browser threat.

i. See infra Part VII.D.

394.1.1. AOL -- well aware of this history -- has no intention of reviving the threat Netscape posed to the applications barrier to entry.

- i. An internal AOL document says that the acquisition of Netscape and the alliance with Sun is "not about Microsoft. We have always considered Microsoft both a tough competitor and an important partner. This deal doesn't change that. Our intention is to continue to use Microsoft's Internet Explorer within the AOL service, because we believe it is important to have AOL bundled with Windows." Colburn, 6/22/99am, at 6:2-17; DX 2522.
- ii. An internal AOL document reads: "beyond the initial reaction to the acquisition, there will be a future overhang on [AOL] if the company appears to be committed to a strategy of competing directly with Microsoft (in Microsoft's, and not [AOL's] business). For the record, no company with such a strategy has been successful." Colburn, 6/22/99am, 7:7-16; DX 2445 (sealed); Fisher, 6/4/99am, 52:15 - 53:10 (testifying that this document supports his conclusion that the AOL acquisition has no significance for Microsoft's monopoly power).
- iii. An internal AOL document discussing

DX 2474

(sealed).

394.1.2. AOL remains highly dependent on Microsoft and for that additional reason is unlikely to mount a platform challenge.

- i. Barry Schuler testified that AOL is an application software company whose success is based on running on top of Windows and is thus “very dependent from the standpoint that Microsoft controls the feature direction of the operating system. And it kind of goes both ways. We depend upon the operating system to run our software upon.” Schuler Dep., 6/22/99am, at 18:20 - 19:7.
- ii. Schuler testified: “Right now the major part of AOL Inc.’s revenue stream is derived from our flagship AOL online service product running on top of the Windows operating system. To the extent that product would be disadvantaged in any way, it could have negative impact on our business.” Schuler Dep. (played 6/22/99am), at 18:20 - 19:7.
- iii. Bob Pittman, AOL’s President, explained that it was essential for AOL to maintain its relationship with Microsoft: “I do think MSFT is too strong to throw them out of the tent — they can hurt us if they think they have no other option. I think we need to stay in business with them, create a need for them to need us . . . and then leave ourselves the flexibility to always accommodate them to a certain extent.” Colburn, 6/14/99am, 40:5-19; GX 2240.

394.2. Second, AOL would be able to mount a serious platform threat only if it were able to obtain a large share of browsers. That could happen only if, among other things, AOL ceased distributing Internet Explorer as its principal client and substituted Netscape instead. That is very unlikely to occur, in part because AOL’s acquisition of Netscape does not change AOL’s incentives with respect to whether to accept Microsoft’s inducements to promote and distribute Internet Explorer as the standard browser with AOL’s software.

394.2.1. AOL was permitted under its contract with Microsoft to terminate its exclusionary OLS agreement in January 1999, a little more than a month after it announced its acquisition of Netscape; but AOL chose not to do so because of the importance to it of remaining featured in the Online Windows Services Folder.

394.2.1.1. Because Netscape had developed a componentized

browser, code named Raptor/Gecko, AOL was technically capable of replacing Internet Explorer AOL's online service software.

- i. Barry Schuler testified that, during the summer of 1998, AOL had assessed the technical viability of using a componentized browser Netscape was developing and was "trying to determine" whether the Netscape componentized technology was a viable option to Internet Explorer. Schuler Dep., 5/5/98, at 26:20 - 27:11 (DX 2810). DX 2668 (indicating AOL had received a demonstration of Netscape's componentized browser).
- ii. An internal AOL document reads:

DX 2513, at AOL/N 0121999 (sealed).

394.2.1.2. AOL nonetheless concluded that the benefits of continued placement in the OLS folder, both the promotion it receives and the added leverage it gives AOL in negotiating with OEMs, outweighed any benefits from adopting Netscape's browser as its principal browser.

- i. Steve Case stated, after the acquisition was announced, that we "plan to continue using Internet Explorer within AOL, because we do want" Microsoft "to continue to be bundled our AOL software with WindowsThe point I was making about IE and AOL, is we do believe it's important to continue to have AOL software bundled with the Windows Desktop, and therefore we are continuing . . . to plan to continue to have IE built into the AOL software." DX 2087.
- ii. Schuler explained why AOL decided to renew its agreement with Microsoft, including the exclusionary

provisions: He stated: “our position in the Online Services folder as a part of the desktop of Windows is a very important contributor, a very important part of our member acquisition program, and represents a fairly large percentage of our overall acquisitions. And so the strength of that position inside of the operating system is very, very important to us.” Schuler Dep. (played 6/22/99am), at 17:3-9; Schuler Dep., 5/5/98, at 60:17 - 61:5 (DX 2810).

- iii. An internal AOL document reads: “In exchange for using IE as our primary browser component, Microsoft bundles [AOL] in the ‘Online Services Folder’ on the Windows desktop. This is an important, valued source of new customers for us, and therefore something we are inclined to continue. Microsoft has made it clear that they will not continue to include us in Windows if we don’t agree to continue our ‘virtual exclusivity’ provisions for use of IE within Apollo.” Colburn, 6/22/99am, at 16:1-18, DX 2518 (sealed); DX 2451.
- iv. Colburn explained that the Internet Explorer agreement with Microsoft is valuable to AOL

Colburn, 6/14/99pm, at 97:14
- 98:7 (sealed session). See also Case Dep., 5/21/99, at
50:6 - 51:20 (DX 2811).

394.2.2. AOL is unlikely to surrender the benefits of placement in the OLS Folder in the foreseeable future and, therefore, is likely to remain subject to Microsoft’s restrictions on AOL’s ability to promote and distribute non-Microsoft browsers.

- i. In the final “Strategic Development and Marketing Agreement” between AOL and Sun Microsystems,

DX 2463, § 6.5 (sealed);
Colburn, 6/14/99pm, at 90:15 - 91:20 (sealed session).

394.2.3. If independent browsers were still a threat to Microsoft's operating system monopoly, Microsoft would have a tremendous incentive to continue to induce AOL, whether through inducements like the OLS Folder or otherwise, not to drop Internet Explorer and to disfavor Microsoft's browser rivals.

- i. Professor Fisher testified that the value Microsoft derives from its agreement with AOL is the "ability to seriously prevent — ward off the" platform "threat or ward off the possible paradigm shift." Fisher, 6/3/99 am, at 21:3-9. Professor Fisher also testified that the AOL agreement benefits Microsoft because "a good deal of the value open to Microsoft in distributing its technology more widely is the maintenance of the application barriers to entry." Fisher, 6/3/99am, at 21:14-20.
- ii. Professor Fisher explained: "if Microsoft could, in either money or other inducements, outbid Netscape, it can make it, and will make it, to the combined companies' advantage not to combine the browser, not to push the browser." Fisher, 1/11/99pm, at 60:4-7.
- iii. In discussing whether Microsoft would (after the Netscape acquisition) still be able to induce AOL to use Internet Explorer exclusively, Dr. Warren-Boulton testified that "if it was worth it for Microsoft to make an offer to AOL that would enable it to preserve its position in the operating system market" before AOL's acquisition of Netscape, "Microsoft still has the same incentive to outbid anyone else for that. It's clearly worth more to Microsoft than to anyone else." Warren-Boulton, 11/23/98am, 65:20 - 66:14.

394.3. Third, even if AOL did adopt Netscape as its principal client at some point in the future, that would neither resurrect the threat that Internet browsers posed nor undo the harm to consumers that Microsoft has inflicted in the browser market and by maintaining its operating system monopoly.

- i. Professor Fisher testified that, even if AOL chose to make the Netscape

browser into a platform and managed to attract developers to write for the platform, developers “will write first and foremost for” Internet Explorer “that has the other 66 percent” browser market share, “and approximately somewhere over 200 million users And a platform-shifting event — a paradigm-shifting event will not occur.” Fisher, 6/3/99am, at 61:15 - 62:6. Professor Fisher testified that: “Microsoft, in fact, succeeded in having IE out to a sufficient extent that . . . it was no longer seen likely that there was going to be a paradigm-shifting event causing people no longer to care very much about the underlying operating system.” “This occurs when Microsoft’s IE share is up around 50 percent.” Fisher, 6/2/99am, at 17:18 - 18:17.

- ii. Professor Fisher testified: “it’s too late and I think Microsoft believes it’s too late. It’s not necessary to have driven Netscape to zero in order for Microsoft to prevent the platform-shifting even or the platform-threatening event that might threaten their operating system monopoly. It’s enough for Microsoft to have obtained a high share of the browser business, and that they’ve done.” Fisher, 6/1/99pm, at 66:3-21.
- iii. An internal AOL document stated:

395. AOL’s acquisition of Netscape does not eliminate the dangerous probability that Microsoft will monopolize the browser market, as Microsoft suggests (Schmalensee Dir. ¶ 3, 634). To the contrary, AOL executives believe that Microsoft will achieve dominance in browsers.

- i. According to internal AOL analysis: “[Netscape] currently has approximately 50 percent browser share with 60 plus percent share of international market. This share has declined over the past two years from 80 percent, and is expected to decline further to approximately 35 percent to 50 percent over the coming two years in the face of Microsoft browser being increasingly tightly integrated with Windows 98.” Schmalensee, 6/24/99am, 72:7-15; DX 2518, at AOL/N 150025 (sealed).
- ii. Dean Schmalensee relied on this document

3. AOL is unlikely to challenge Microsoft's monopoly in other ways, and the other devices it may develop would not affect Microsoft's operating system monopoly

396. Microsoft argued that, even if AOL's acquisition of Netscape will not reinvigorate the browser threat, Microsoft's actions designed to vitiate the browser threat did no lasting harm to competition because AOL can challenge Microsoft's operating system monopoly in other ways. This argument is contrary to the evidence.

396.1. First, AOL has no plans to compete against Microsoft by developing a rival operating system or platform that it would position as an alternative to Windows.

396.1.1. AOL has no intention of challenging Microsoft in operating systems, either directly by producing an operating system or indirectly by seeking to create a platform to which ISVs would write instead of to Windows.

- i. Case stated publicly and testified that AOL has no intentions of competing with Microsoft's core business. Mr. Case further stated and testified: "AOL's merger with Netscape has no bearing on the Microsoft case, as nothing we're doing is competitive with Windows. . . . We have no flight of fancy that we can dent in any way, shape or form what is a Microsoft monopoly in the operating system business. Case Dep. (played 6/4/99am), at 43:13 - 44:16; Court Ex. 1; see also Fisher, 1/6/99am, at 44:13 - 45:21 testifying that Mr. Case's comments are consistent with his understanding of the impact of the Netscape acquisition, insofar as developing viable competition to Microsoft's monopoly).
- ii. Dean Schmalensee testified that he found no reference in any of AOL's internal documents of any intent by AOL to develop an operating system that would be available to OEM's as an alternative to preloading Windows on PCs. Schmalensee, 6/24/99am, at 67:2-9.
- iii. An internal AOL document reads: AOL "is not in the operating

system business and has no plans to enter that business. Our strategy is to work with multiple vendors where possible, so we are not totally reliant on any one.” DX 2518, at AOL/N 015094 (sealed); Colburn, 6/14/99am, at 60:4-15; Colburn, 6/22/99am, at 17:20 - 18:2; DX 2451.

- iv. Schuler testified that he did not consider AOL’s client software to be an operating system and that AOL has no plans to develop and market an operating system. Schuler Dep., 6/22/99am, at 18:6-8, 17-20. Schuler stated: AOL is “an application software company that does software and also has online software services. And our success has been based on running on top of Windows and Macintosh. And we’re in the application software business and that’s what all of our future plans are predicated on.” Schuler Dep., 6/22/99am, at 18:9-16.
- v. Colburn testified that the deal “has nothing to do” with “operating systems. I think everybody has made it clear we’re not in the operating system business, and we do encourage, and we give them functionality that we think is appropriate for an online world and what our customers want.” Colburn, 6/14/99pm, at 27:1 - 28:5.
- vi. An internal AOL analysis reads:

DX 2474 (sealed).

396.1.2. Microsoft itself does not regard AOL, even after the acquisition, as a significant operating system or platform threat.

- i. During a presentation on or about December 14, 1998, Bill Gates, discussing potential competitive effects of AOL’s acquisition of Netscape and specifically the topic of “platform threats,” expressed the view that “AOL doesn’t have it in their genes to attack us in the platform space.” GX 2241 (sealed; cited portion published); Schmalensee, 6/24/99am, at 65:3-9, 66:4-7.

396.1.3. Although AOL briefly contemplated developing a low-cost alternative to the PC, the “AOL PC,” it quickly abandoned the idea.

- i. Colburn described two different AOL plans for an “AOL PC.” He testified: “One would be where it runs on Windows, and really it’s the only application that’s there beyond what Windows requires. And that’s what we call an AOL PC.” The second “might be in a sort of PC functionality, but that could conceivably run on a different operating system. As to the second, . . . I think we’ve had some limited discussions with . . . some OEMs on this, or relatively few, but its never come to fruition in any way. It just seems to hard to do.” Colburn, 6/14/99am, at 61:7 - 62:5.
- ii. Colburn further testified: “I think pretty much the latter type of AOL PC and building a PC-type functionality that is really an alternative to Windows are largely dead. I don’t know any current ones going on.” Colburn, 6/14/99am, at 62:6-11.
- iii. Colburn also testified that, with regard to the “AOL PC,” AOL was “looking to figure out a way to create . . . the lowest cost PC we could. Our sense was if you could strip away most of the guts and just have a very thin operating system in it with AOL client running on it, you could drive the cost of the PC down.” However, “this has never come to fruition, at least in part because . . . that PCs have come down substantially in price.” Colburn, 6/14/99am, at 69:1-20. See also Colburn, 6/14/99am, at 62:20 - 63:4 (“the real goal was to bring the price down on the machine...And then what has happened in the price has sort of fallen out in the PC market anyway, so the real need to come up with an alternative had sort of gone away.”)
- iv. Case made clear that AOL has no plans to compete with Microsoft in the PC business. Mr. Case testified: “I’ve heard the term ‘AOL PC’, but that doesn’t mean we’re necessarily focusing on that as a major part of our strategy. . . . We want to really make AOL available in many ways. But we don’t think being in the PC business makes sense for AOL. We think partnering with companies in that business is a better approach. And obviously all those companies will be working closely with Microsoft.” Case Dep., 5/21/99, 78:17 - 79:2 (DX 2811).

396.2. Second, the information appliances AOL is pursuing are complements to the PCs, rather than substitutes for it.

- i. Case stated publicly and testified that: "It's harder to imagine that PCs won't be the dominant way people connect with the Internet for many years to come, and Microsoft has a pretty amazing lock on that business. . . . Other devices will emerge, but I doubt any will challenge Windows." Case Dep., 6/4/99am, at 44:17 - 45:4.
- ii. Schuler testified that AOL views information appliance devices, like the Palm Pilot, Windows CE devices, NCs and set top boxes. as companions and not replacements to desktop PCs. He testified that AOL's

DX

2810A (sealed).

- iii. AOL is not the only firm in the industry with this view. On May 31, 1999, Bill Gates stated in an article he wrote for Newsweek: "For most people at home and at work, the PC will remain the primary computing tool But the PC will also work in tandem with other cool devices. You'll be able to share your data -- files, schedule, calendar, email, address book, etc. -- across different machines; you won't have to think about it; it will be automatic." GX 2059.
- iv. Professor Fisher testified that "PCs are a separate object. PCs share some functions with . . . certain hand-held devices, but the hand-held devices really aren't substitutes for PCs. And you can perfectly well have a monopoly in operating systems for PCs, despite the fact that there are or may be a number of operating systems for hand-held devices, TV set-top boxes, and so on." Fisher, 1/12/99am, 7:4-16.

396.3. Third, even if, as Microsoft asserts, AOL were to develop substitutes for PCs and support the development of server-based, operating system-independent applications, Microsoft's ability to influence network-centric standards will ensure that such applications do not erode the applications barrier to entry or its operating system monopoly.

- i. See infra, Part VII.D.