IN RE MICROSOFT CORP. ANTITRUST LITIGATION

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The Department of Justice's suit against Microsoft for antitrust violations has been headline news for the past few years. While much attention has focused on the government's case against Microsoft, an important decision regarding the private suits by consumers against the software giant also warrants discussion. In *In re Microsoft Antitrust Litigation*, the United States District Court for the District of Maryland applied the *Illinois Brick* doctrine to dismiss 38 private antitrust lawsuits filed against Microsoft. The *Illinois Brick* doctrine was established at a time when the phrase "bricks and mortar" referred only to building materials and computer software was a term only scientists and engineers used. The doctrine, which forbids private antitrust suits by indirect purchasers of a product, was structured around traditional notions of products and services. Many of the underlying principles supporting the *Illinois Brick* doctrine do not apply to our information-driven economy. In *Microsoft*, the court was faced with difficult questions regarding the application of the *Illinois Brick* doctrine to the software industry. Rather than answering these questions, the court dismissed them with little discussion.

This Note will consider two of the plaintiffs' arguments in the *Microsoft* case and conclude that *Illinois Brick* should not bar private antitrust lawsuits against Microsoft. First, this Note will explore the plaintiffs' assertion that their case falls within the control exception to the direct purchaser rule because Microsoft controls the Original Equipment Manufacturers ("OEMs"). This Note will then discuss plaintiffs' argument that *Illinois Brick* does not bar their suits because consumers are direct purchasers of Microsoft's product. While the court's refusal to apply the control exception was consistent with precedent, if not good policy, the court should have accepted the plaintiffs' second argument. The software industry generally licenses products to consumers, rather than sell them to OEMs outright. Therefore, the court should have held that Microsoft sells its product directly to the consumer, barring application of the *Illinois Brick* doctrine.

I. LEGAL BACKGROUND

Section four of the Clayton Act provides that "any person who shall be injured in his business or property by reason of anything forbidden in the

antitrust laws may sue therefore . . . and shall recover threefold the damages . . . ."[1] Congress had two broad objectives when it allowed private enforcement of the antitrust laws. First, Section 4 was enacted to compensate victims of antitrust violations for their injuries.[2] Congress's second objective was deterrence; Section 4 was meant to deter antitrust violations by imposing significant costs on violators.[3] While these goals imply broad power to sue under the antitrust laws, the Supreme Court has limited the private right of action in antitrust suits. A central limitation in many private suits, including the suits against Microsoft, is the direct purchaser rule established in *Illinois Brick Co. v. Illinois*.[4]

A. Direct Versus Indirect Purchasers

The Court first established the distinction between direct and indirect purchasers in antitrust law in *Hanover Shoe v. United Machine Corp.*[5] A direct purchaser is the initial buyer in the vertical supply chain, who therefore buys directly from the monopolizing firm.[6] An indirect, or downstream, purchaser is one who purchases a price-fixed product from a middleman, who will have passed on the anticompetitive overcharge to his customer.[7] Often, the direct purchaser of the monopoly product is not the final consumer; distributors or other manufacturers higher up on the vertical supply chain are the direct purchasers.[8] According to the pass-on theory, the direct purchaser absorbs part of the overcharge and passes the rest on to the next link in the supply chain.[9] The process is repeated as each indirect purchaser sells to the next indirect purchaser in the chain. In the end, however, the final product purchased by consumers reflects the majority of the overcharge.[10] In *Hanover Shoe*, defendants argued that plaintiff shoe manufacturers should not be allowed to sue under Section 4 because they had passed on the alleged overcharge to their customers.[11] The

1. 15 U.S.C. § 15(a) (1994).
2. Jill S. Kingsbury, *The Indirect Purchaser Doctrine: Antecedent Transaction?* 65 MO. L. REV. 473, 477 (2000).
3. *Id.*
4. 431 U.S. 720 (1977).
5. 392 U.S. 481 (1968).
6. Kingsbury, *supra* note 2, at 478.
7. *Id.*
8. *Id.*
9. *Id.*
10. *Id.*
11. 392 U.S. at 491-92.

Supreme Court rejected this argument and barred the use of the pass-on theory as a defense.[12]

B. *Illinois Brick* Doctrine

The Supreme Court's decision in *Illinois Brick* further restricted the use of the pass-on theory.[13] In that case, the Court held that indirect purchasers of goods and services from firms engaged in price fixing could not use a pass-on theory to recover for the alleged antitrust violations.[14] The plaintiffs argued that they were entitled to recover damages because the direct purchasers passed on the overcharge to them.[15] The Court explained that only direct purchasers could sue for alleged antitrust violations.[16] The plaintiffs in *Illinois Brick* were public entities that owned buildings constructed with concrete block purchased from defendants by subcontractors.[17] The plaintiffs sought to recover treble damages under Section 4 of the Clayton Act.[18] They alleged that defendants conspired to fix prices of concrete block in violation of Section 1 of the Sherman Act.[19]

The Court denied the indirect purchasers' claims on three grounds. The Court first reasoned that the rule regarding the pass-on theory must apply equally to both plaintiffs and defendants.[20] Otherwise, if indirect purchasers were free to sue for overcharges passed on, and defendants could not use the pass-on defense against direct purchasers, defendants would be subject to multiple liabilities. The *Illinois Brick* Court had either to reverse *Hanover Shoe* or to prohibit the use of the pass-on theory by the plaintiffs if it was to avoid multiple liabilities for defendants.[21] The Court opted to deny the use of pass-on theory completely.[22]

The Court also feared that suits by indirect purchasers would get out of control because each downstream purchaser would attempt to show the amount of damages it suffered as a result of some remote price-fixing

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12. *Id.* at 488.
13. *See* Roger D. Blair & Jeffrey L. Harrison, *Reexamining the Role of* Illinois Brick *in Modern Antitrust Standing Analysis,* 68 GEO. WASH. L. REV. 1 (1999) (discussing the restrictions on use of the pass-on theory).
14. 431 U.S. at 747.
15. *Id.* at 727.
16. *Id.* at 728.
17. *Id.* at 726.
18. *Id. See also* 15 U.S.C. § 15 (1994).
19. 15 U.S.C. § 1 (1994).
20. 431 U.S. at 729.
21. *Id.* at 730.
22. *Id.*

scheme.[23] Federal courts would therefore be left with the impossible task of apportioning damages among direct and indirect victims.[24] The Court explained that allowing the plaintiffs to assert pass-on theories would "greatly complicate and reduce the effectiveness of already protracted treble-damages proceedings."[25]

Finally, the Court found that the value of deterring violations of the antitrust laws and depriving violators of gains from illegal activity outweighed the need to compensate victims for antitrust violations.[26] The Court held that concentrating the full recovery in direct purchasers would provide a greater incentive for them to bring actions, thereby deterring others from committing similar violations.[27] The Court did not have a problem with direct purchasers collecting the full amount of the overcharge, even if it exceeded the actual harm they suffered.

C. Exceptions to the Direct Purchaser Rule

In two footnotes of the opinion, the *Illinois Brick* Court left open two possible ways for indirect purchasers to recover treble damages for an overcharge. An indirect purchaser can recover if either: (1) the indirect purchaser has a preexisting cost plus contract with the direct purchasers or (2) the direct purchaser is owned or controlled by its customer.[28] The second exception actually applies both when the indirect purchaser controls the direct purchaser and when the price fixing firm controls the direct purchaser.[29] Courts have interpreted these two exceptions to the direct purchaser rule narrowly, however, and the Supreme Court has eliminated the possibility of other exceptions to the rule.

At first, it appeared that courts could interpret the exceptions to the direct purchaser rule broadly, allowing indirect purchasers to sue in other situations. In *California v. ARC America Corp.*,[30] the Supreme Court stated that "indirect purchasers might be allowed to bring suit in cases in which it would be easy to prove the extent to which the overcharge was

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23. *Id.* at 732.
24. *Id.*
25. *Id.*
26. *Id.* at 746.
27. *Id.*
28. *Id.* at 736, n.16.
29. *In re* Microsoft Corp. Antitrust Litig., 127 F. Supp. 2d 702, 712 (D. Md. 2001). *See also In re* Brand Name Prescription Drugs Antitrust Litig., 123 F.3d 599, 605 (7th Cir. 1997); Jewish Hospital Ass'n v. Stewart Mech. Enters., 628 F.2d 971, 975 (6th Cir. 1980); *In* re Mid-Atlantic Toyota Antitrust Litig., 516 F. Supp. 1287, 1292 (D. Md. 1981).
30. 490 U.S. 93 (1989).

passed on to them."[31] However, in *Kansas v. Utilicorp United, Inc.*,[32] the Supreme Court retreated from this broad interpretation of the *Illinois Brick* exceptions and severely narrowed application of exceptions to the direct purchaser rule.

In *Utilicorp*, the Court completely eliminated the possibility of any policy-based exceptions to *Illinois Brick*. In that case, public utilities filed suit against natural gas producers and pipeline companies for antitrust violations.[33] Kansas and Missouri also filed suits asserting similar antitrust claims in *parens patriae* capacity on behalf of residential consumers who purchased gas from the public utilities.[34] The states argued that consumers paid inflated prices because a pipeline and a group of gas production companies were fixing prices.[35] Residents of Kansas and Missouri, however, were indirect purchasers of natural gas because they purchased from utilities, not gas producers.[36] The states claimed that their suit should nonetheless move forward because utilities, which were the direct purchasers, passed on the full overcharge to consumers and thus the apportionment problem present in *Illinois Brick* did not exist.[37]

The majority rejected the plaintiffs' assertion. The Court held that "only the utility has the cause of action because it alone has suffered injury within the meaning of § 4."[38] The plaintiffs asserted that none of the rationales underlying *Hanover Shoe* and *Illinois Brick* exist in cases involving public utilities. The Court, however, stated that, while the rationales of *Hanover Shoe* and *Illinois Brick* might "not apply with equal force in all instances," it was "inconsistent with precedent and imprudent in any event to create an exception for regulated public utilities."[39]

The application of the control exception to private Microsoft lawsuits is further complicated by the Seventh Circuit's holding in *In re Brand Name Prescription Drugs Antitrust Litigation* ("*PDAL*").[40] In that case, the Seventh Circuit applied a narrow interpretation of the control exception to the direct purchaser rule. Plaintiff pharmacies sued both manufacturers and wholesalers of prescription drugs alleging a price-fixing con-

31. *Id.* at 102, n.6 (dictum).
32. 497 U.S. 199 (1990).
33. *Id.* at 203.
34. *Id.* at 204.
35. *Id.* at 204-5.
36. *Id.* at 207.
37. *Id.* at 208.
38. *Id.* at 204.
39. *Id.* at 216.
40. 123 F.3d 599 (7th Cir. 1997).

spiracy.[41] The pharmacies claimed that defendants conspired among themselves to deny them discounts from the list price of brand name drugs and maintained this differential pricing through a "chargeback" system.[42] Under the system, manufacturers signed contracts which favored some customers, including hospitals, health maintenance organizations, nursing homes, and mail order companies, setting a discounted price at which these customers were entitled to buy from wholesalers.[43] The manufacturers then reimbursed the wholesalers for the difference between the regular wholesale price and the discounted price.[44] The plaintiffs' claim was not based on the discrimination as such; it was based on the high prices that resulted as a consequence of defendants' conspiracy, prices that competition would have otherwise brought down.[45]

Manufacturers argued that pharmacies that purchased the drugs from wholesalers were indirect purchasers; therefore, the direct purchaser rule prevented them from bringing suit.[46] The district court interpreted the control exception to the direct purchaser rule broadly to allow suits by indirect purchaser pharmacies.[47] The district court asserted that the control exception should apply where "the degree of control exercised by the defendant effectively transforms the transaction—from defendant to middleman to indirect purchaser—into one sale."[48]

The Seventh Circuit rejected the district court's broad reading of the control exception. The court held that pharmacies were not allowed to bring suit for overcharges under the Sherman Act against manufacturers for purchases made through wholesalers.[49] According to the court, "[t]he manufacturers do no control the wholesalers through interlocking directorates, minority stock ownership, loan agreements that subject the wholesalers to the manufacturers' operating control, trust agreements, or other modes of control separate from ownership of a majority of the wholesalers' common stock" and thus the control exception did not apply.[50]

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41. *Id.* at 603.
42. *Id.*
43. *Id.*
44. *Id.*
45. *Id.*
46. *Id.* at 604.
47. *Id.*
48. In re Brand Name Prescription Drugs Antitrust Litig., No. 94 C 897, 1996 U.S. Dist. LEXIS 4335, at *88 (N.D. Ill. Apr. 4, 1996) (citing Jewish Hosp. Ass'n v. Stewart Mech. Enters., 628 F.2d 971 (6th Cir. 1980)).
49. *In re* Brand Name Prescription Drugs Antitrust Litig., 123 F.3d at 605-06.
50. *Id.*

D. Federal Preemption of State Indirect Purchaser Statutes

After the Supreme Court's decision in *Illinois Brick*, a number of states and the District of Columbia enacted *Illinois Brick* repealer statutes.[51] These statutes allowed indirect purchasers to sue under state antitrust laws. In one of the most significant decisions regarding private antitrust litigation, the Supreme Court held that federal antitrust law did not preempt state *Illinois Brick* repealer statutes.[52]

In *California v. ARC America Corp.*, the plaintiffs were state governments that were indirect purchasers of cement.[53] The plaintiffs filed their lawsuits under both federal antitrust law and under state antitrust laws that allowed suits by indirect purchasers. The Supreme Court was forced to decide whether *Illinois Brick* and *Hanover Shoe* preempted state laws permitting indirect purchasers to recover damages against antitrust violators.[54] The Court held that preemption did not occur in this case because Congress did not intend to occupy the field and the state statutes did not actually conflict with federal law.[55] The Court explained that suits by indirect purchasers would not necessarily complicate matters in federal courts.[56] State antitrust issues would be decided in state courts and federal courts could decline to consider state claims.[57] The Court also found that allowing indirect purchasers to sue under state antitrust laws would not decrease the incentive for direct purchasers to sue under federal antitrust laws.[58] Finally, the Court addressed the issue of multiple liabilities by stating that the Court has never identified a federal policy against states imposing liability in addition to that imposed by federal law.[59]

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51. *Illinois Brick* repealer statutes were enacted by Alabama, Arizona, California, Colorado, District of Columbia, Hawaii, Idaho, Illinois, Kansas, Maine, Maryland, Michigan, Minnesota, Mississippi, Nevada, New Mexico, New York, North Carolina, North Dakota, Rhode Island, South Dakota, Tennessee, Vermont, and Wisconsin. *See* Thomas Greene et al., *State Antitrust Law and Enforcement,* 1252 PLI/CORP 1129 (2001).

52. California v. ARC Am. Corp., 490 U.S. 93 (1989).

53. *Id.* at 97-98. For a complete discussion of *California v. ARC America Corp.*, see Ronald W. Davis, *Indirect Purchaser Litigation:* ARC America*'s Chickens Come Home to Roost on the* Illinois Brick *Wall,* 65 ANTITRUST L.J. 375 (1997).

54. 490 U.S. at 100.

55. *Id.* at 103.

56. *Id.*

57. *Id.* at 104.

58. *Id.* at 105.

59. *Id.*

E. The Relation Between Antitrust Standing Doctrine and *Illinois Brick*

While *Illinois Brick* appears to be about standing under federal antitrust law, the Supreme Court has not treated it as such. The Court developed a multipart test for determining antitrust standing in *Associated General Contractors, Inc. v. California State Council, Inc.* ("*AGC*").[60] To have standing to sue, the plaintiff must have suffered an antitrust injury.[61] Once injury is established, a court must weigh the remoteness of the injury, the existence of a potential plaintiff with greater motivation to sue, and the complexity of the ensuing litigation, before the plaintiff is permitted to bring an action.[62] It seems logical that suits by most indirect purchasers would be barred by the second part of the *AGC* test. It is likely that the injury to indirect purchasers would be too remote, that there would be other plaintiffs with greater motivation to bring an action, and that litigation by an indirect purchaser would be overly complex.[63] However, the Court has not folded *Illinois Brick* into a general standing analysis.[64] Instead, *Illinois Brick* is viewed as analytically distinct from the *AGC* test.[65] So, while some indirect purchasers might pass the *AGC* standing test, their suits are nonetheless automatically barred under *Illinois Brick.*

II. CASE SUMMARY

A. Factual Background

In May 1998, the U.S. government and nineteen states filed suit against Microsoft alleging antitrust violations under sections one and two of the Sherman Act. As the Department of Justice's highly publicized suit against Microsoft progressed, consumers in various states filed private suits for treble damages under Section 4 of the Clayton Act and under state antitrust laws. Microsoft transferred sixty-one antitrust actions to a multidistrict litigation in a Maryland federal court.[66]

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60. 459 U.S. 519 (1983).
61. *Id.* at 540.
62. *Id.* at 542-544.
63. *See* Blair & Harrison, *supra* note 13, at 16-17.
64. *Id.*
65. *Id.* at 17.
66. The suits were consolidated under 28 U.S.C. § 1407(a), entitled Multidistrict Litigation, which states that "when civil actions involving one or more common questions of fact are pending in different districts, such actions may be transferred to any district for coordinated or consolidated pretrial proceedings."

The plaintiffs in the multidistrict litigation made several allegations regarding Microsoft's exclusionary, predatory and anticompetitive acts. The plaintiffs alleged that Microsoft intentionally caused end users to suffer unique injury as a direct result of Microsoft's restrictive and exclusionary practices.[67] The plaintiffs maintained that Microsoft deprived end users of the benefits of competition including "technological innovation, market choice, product variety and substitutable supply."[68] Furthermore, Microsoft's end-user license agreement ("EULA") restrictions forced consumers to acquire a new EULA with each new PC, and thus deprived consumers of other products.[69]

According to the plaintiffs, Microsoft abused its operating system licensing monopoly power so as to anticompetitively deprive consumers of any new technology that would permit consumers to use applications without the Microsoft operating system.[70] The new technology included, among other things, the DR-DOS and OS/2 operating systems, Mirrors, Object Windows Library, Native Signal Processing, Netscape and Sun Microsystem's Java programming language.[71] With respect to Java, for example, Microsoft deceived Java developers by leading them to believe that Microsoft's Java Virtual Machine ("JVM") was compatible with Sun's JVM and vice versa.[72] Microsoft sought to quash the development of Java because it feared that it would make all operating systems compatible with one another. Furthermore, the plaintiffs claimed that once Microsoft eliminated all products that competed with its operating system, it began charging a higher price and imposed far more anticompetitive restrictions on end users.[73]

The court in *In re Microsoft Corp. Antitrust Litigation*, dismissed damages claims in many of the cases consolidated in the Maryland federal court.[74] The court granted Microsoft's motion to dismiss as to cases filed by consumers who did not purchase their products directly from Microsoft and as to foreign plaintiffs, but remanded those cases that had valid state claims back to state court.[75] The court held that suits by consumers who did not purchase Microsoft's product directly from Microsoft and who

67. *In re* Microsoft Corp. Antitrust Litig., 127 F. Supp. 2d 702, 706 (D. Md. 2001).
68. *Id.*
69. *Id.* at 707.
70. *Id.* at 705.
71. *Id.* at 706-08.
72. *Id.* at 708.
73. *Id.* at 707.
74. *Id.* at 704.
75. *Id.*

sought to recover an overcharge were barred under the direct purchaser rule of *Illinois Brick*.[76]

B. The Multi-district Litigation Analysis and Conclusion

1. Illinois Brick *Issues*

In deciding whether *Illinois Brick* barred the plaintiffs' suit, the court asked two questions. First, were the plaintiffs seeking damages for an illegal overcharge?[77] And second, were the plaintiffs indirect purchasers of Microsoft product?[78] The court answered both questions in the affirmative, and thus held that the *Illinois Brick* doctrine barred their lawsuits.

The court focused on the question of whether the plaintiffs were claiming damages for an illegal overcharge. The plaintiffs' damages claims fell into four general categories.[79] The plaintiffs first claimed damages for supracompetitive prices for Windows and three application programs: Word, Excel, and Office Suites.[80] Second, the plaintiffs sought damages for denial of the benefit of technologically superior products, including alternative operating systems and application programs.[81] The plaintiffs' third damages claim arose out of increased restriction on their EULA rights.[82] Finally, the plaintiffs claimed damages from degradation of computer performance by the tying of Internet Explorer to Windows.[83] The court denied all four types of the plaintiffs' damages claims.

The court held that the plaintiffs' claim for supracompetitive prices was clearly barred under *Illinois Brick* because the plaintiffs sought recovery for illegal overcharges.[84] The court next rejected the plaintiffs' damages claims for denial of the benefit of technologically superior products, holding that the damages amounted to a measurable overcharge. Moreover, the court held that the plaintiffs lacked standing to assert these claims because Microsoft's competitors were more direct victims of the alleged antitrust violations, and because calculating and apportioning the plaintiffs' damages would be virtually impossible.[85] The court also denied the plaintiffs' claims that they were damaged by Microsoft's increased

76. *Id.*
77. *Id.* at 709.
78. *Id.* at 708.
79. *Id.* at 709.
80. *Id.*
81. *Id.*
82. *Id.* at 710.
83. *Id.*
84. *Id.*
85. *Id.* at 711.

EULA restrictions.[86] The court held that these claims amounted to a claim for an overcharge, and were therefore barred by *Illinois Brick*.[87] Finally, the court rejected the plaintiffs' last damages claim because it did not constitute an antitrust injury. The court held that the plaintiffs' claims for degradation of the performance of their computers caused by the alleged tying of Internet Explorer to Windows was only incidentally related to the alleged anticompetitive behavior.[88]

The plaintiffs in the Microsoft multi-district litigation argued that they were direct purchasers of Microsoft's product.[89] They maintained that the product they purchased was not the software, but EULAs that ran between Microsoft and themselves.[90] The court quickly rejected the plaintiffs' claims that they were direct purchasers.[91] It held that, although the EULA may have established a direct relationship between Microsoft and the plaintiffs, it was not sufficient to make them "direct purchasers" within the meaning of *Illinois Brick*.[92]

The plaintiffs also argued that their case fell within the control exception to *Illinois Brick*. Microsoft, they argued, used its monopoly power "to capture, dominate and exclusively control the OEM distribution channel."[93] Microsoft also forced OEMs to act as its agents in offering end-user licenses for acceptance or rejection by customers under terms strictly and exclusively dominated by Microsoft.[94] The court held that the control exception should be narrowly construed to include only "relationship[s] involving such functional economic or other unity . . . that there effectively has been only one sale."[95]

The court further held that the control exception only applies where the price fixing firm controls the direct purchaser "through interlocking directorates, minority stock ownership, loan agreements that subject wholesalers to the manufactures' operating control, trust agreement, or other modes of control separate from ownership of a majority of the

86. *Id.* at 712.
87. *Id.*
88. *Id.*
89. *Id.* at 709.
90. *Id.*
91. *Id.*
92. *Id.*
93. *Id.* at 713.
94. *Id.*
95. *Id.* (quoting Jewish Hosp. Ass'n v. Stewart Mech. Enters., 628 F.2d 971, 975 (6th Cir. 1980).

wholesalers' common stock."[96] Finding that OEMs are clearly independent entities capable of making their own decisions, the court refused to apply the control exception to *Illinois Brick*.[97] The court nonetheless implied that if Microsoft controlled the OEMs' decision-making process with respect to setting prices, the control exception might apply. However, the plaintiffs did not allege, and the court did not find, that Microsoft controlled the OEMs' pricing decisions.[98]

C. Private Microsoft Suits Filed Under State Antitrust Laws

Microsoft's victory under the federal antitrust laws will not necessarily translate into victory under state antitrust laws. If consumers in the states that have enacted *Illinois Brick* repealer statutes can show Microsoft abused its monopoly power, they can sue under those states' antitrust laws. In fact, dozens of private suits are still moving forward in several states. Consumer suits in Arizona, California, Michigan, and Minnesota have already been granted class-action status.[99] Microsoft may face its toughest battles under these state laws, especially in states like California, where there are strong pro-consumer laws. The option of state law actions may make it unlikely that the plaintiffs will appeal the Maryland federal court's decision.

III. DISCUSSION

The *Microsoft* plaintiffs' arguments regarding the control exception and direct purchasing of licenses deserve more serious consideration than the court gave them. According to the plaintiffs, the control exception to *Illinois Brick* should apply in this case because Microsoft exhibits substantial control over the direct purchasers, the OEMs. Thus, the direct purchaser rule should not bar private antitrust suits against Microsoft by consumers. The court's decision not to apply the control exception may be consistent with precedent, but it is not consistent with good policy or the goals of *Illinois Brick*. Even if the court's refusal to apply the control exception was proper, the plaintiffs' suits should not have been dismissed. The plaintiffs also claimed that consumers are direct purchasers of Microsoft's product because consumers purchased the EULA, which is the actual product, directly from Microsoft. The court rejected this argument

96. *Id.* (quoting *In re* Brand Name Prescription Drugs Antitrust Litig., 123 F.3d 599, 605-06 (7th Cir. 1997)).

97. *Id.*

98. *Id.*

99. *Private Microsoft Suit Wins Class-action Status*, CNET NEWS, Apr. 5, 2001, *at* http://news.com.com/2100-1001-255410.html?legacy=cnet.

without really addressing the plaintiffs' assertions. One does not ordinarily think of a contract as the product, but given the nature of the software industry, it is surprising that the court dismissed the plaintiffs' argument so quickly. The court should have accepted the argument that consumers are direct purchasers because it is consistent with both software industry practices and the court's treatment of software licenses.

A. The Control Exception of *Illinois Brick*

The plaintiffs in the private suits against Microsoft argued that the control exception to the direct purchaser rule applied in their case because Microsoft used its monopoly power to control the OEM distribution channel.[100] The court refused to apply the control exception, holding that OEMs were still capable of making their own decisions.[101] There are, however, strong arguments that support applying the control exception to the suits against Microsoft.

Microsoft is a uniquely powerful monopoly, possessing a market share of over 95%.[102] Microsoft's monopoly is a consequence of anticompetitive practices and network effects[103] in the software industry. In the years leading up to the antitrust litigation, the combination of restrictive licenses and network effects effectively gave Microsoft control over the OEMs. Microsoft controlled OEMs using restrictive license agreements, which prohibited the OEMs from doing such things as removing any desktop icons, folders, or "Start" menu entries, altering the initial boot sequence, or otherwise altering the appearance of the Windows desktop.[104] Microsoft imposed these restrictions on OEMs in an effort to prevent them from installing Netscape or any other program that threatened Microsoft's market power.[105] Network effects in the computer industry also contributed to Microsoft's power over the OEMs. OEMs could not risk standing up to Microsoft without being driven out of business if Microsoft stopped dealing with them. The OEMs did not have other valid options for an operating system; consumers would not buy a computer that did not have an op-

100. *In re Microsoft*, 127 F. Supp. 2d at 712.

101. *Id.* at 713.

102. U.S. v. Microsoft Corp., 253 F.3d 34, 52 (D.C. Cir. 2001).

103. When network effects are present, a product becomes more attractive to buyers as more people use the product. Microsoft's operating system is an example of a virtual network, one in which consumers are not actually connected to each other. A second type of network is a real network, one where consumers are connected; for example, fax machines. *See* CARL SHAPIRO & HAL R. VARIAN, INFORMATION RULES: A STRATEGIC GUIDE TO THE NETWORK ECONOMY 3, 174-75 (1999).

104. *Microsoft Corp.*, 253 F.3d at 60.

105. *Id.* at 59.

erating system for which software was available. Microsoft therefore had substantial power over the OEMs.

The legal standard for the control exception, however, requires Microsoft to exhibit a much higher level of control over OEMs. According to the Seventh Circuit decision in *PDAL*, customers must demonstrate that Microsoft controlled the OEMs through "interlocking directorates, minority stock ownership, loan agreements that subject the wholesalers to the manufacturers' operating control, trust agreement, or other modes of control separate from ownership of a majority of the wholesalers' common stock."[106] The *PDAL* opinion also implies that "the manufacturers' ability to dictate wholesalers' pricing policies would permit the plaintiffs to avail themselves of the control exception to *Illinois Brick* only if the manufacturers had affirmatively intervened in the wholesalers' pricing decisions vis-à-vis plaintiffs."[107]

If manufacturers had used their economic power to force wholesalers to raise prices the Seventh Circuit might have applied the control exception and permitted the plaintiffs to sue. This interpretation of *PDAL* seems consistent with the *Microsoft* court's interpretation. Recall that the court stated that the plaintiffs did not allege that Microsoft controlled the intermediaries' decision-making processes with respect to setting prices.[108] According to the court, the setting of prices is a critical issue in applying the control exception.[109] While Microsoft exerted substantial control over the OEMs, it does not appear that Microsoft controlled the OEMs' price setting practices. Thus, under the Seventh Circuit's standard, it is clear that the court's holding that the control exception did not apply to the *Microsoft* case was correct.

The court's decision not to create another exception to the direct purchaser rule based on Microsoft's unique position in the market was also consistent with precedent. After the Supreme Court's holding in *Utilicorp*, it is apparent that courts should not create any further exceptions to the *Illinois Brick* doctrine based on policy considerations, even in cases where the monopolizing firm has such a high market share. While Microsoft's control over the market for Intel-compatible PCs is substantial, the *Utilicorp* Court held that there are ample justifications for not carving out ex-

106. *In re* Brand Name Prescription Drugs Antitrust Litig., 123 F.3d 599, 605-06 (7th Cir. 1997).

107. Michael S. Jacobs, *Lesson From the Pharmaceutical Antitrust Litigation: Indirect Purchasers, Antitrust Standing, and Antitrust Federalism*, 42 ST. LOUIS U. L.J. 59, 77 (1998).

108. *In re* Microsoft Corp. Antitrust Litig., 127 F. Supp. 2d at 713.

109. *Id.*

ceptions to the direct purchaser rule for particular types of markets. According to the majority, "the possibility of allowing an exception, even in rather meritorious circumstances, would undermine the rule."[110]

Recent precedent therefore supports the court's holding that consumers in the *Microsoft* case did not meet the technical requirements for the control exception. The court's finding, however, implies a problem with interpretation of the control exception, not a lack of control. The *Illinois Brick* court explained that the exceptions to the direct purchaser rule were designed to cover situations in which market forces have been superseded.[111] The court's language suggests that the exceptions to the direct purchaser rule should be interpreted broadly. There is no doubt that market forces have been superseded in the *Microsoft* case. Furthermore, the *Illinois Brick* Court's language does not suggest that the two exceptions were meant to be exclusive.[112] The exceptions only provide concrete examples of which exceptions to the direct purchaser rule will best serve the policies underlying the Court's opinion.[113] The exceptions suggest that indirect purchasers may sue when the direct purchaser has little motivation to sue.[114] Consumers should therefore be able to sue Microsoft for antitrust violations because the OEMs have not, and likely will not, sue Microsoft.[115]

A fundamental goal of the Supreme Court in *Illinois Brick* was to ensure that the party with the most motivation to sue could sue.[116] The Court stressed that the goal of deterrence was more important than the need to compensate victims of antitrust violations.[117] In the *Microsoft* case, the consumer is the party with the most motivation to sue; in fact the consumer is the only party with motivation to sue. OEMs with no viable alternative to Microsoft's products cannot risk suing their only supplier.

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110. Kansas v. Utilicorp United, Inc., 497 U.S. 199, 216 (1990).

111. Illinois Brick v. Illinois, 431 U.S. 720, 736 n.16 (1977).

112. Jerome Musheno, *Antitrust Law—Should Standing Be an Issue for the Indirect Purchaser in a Vertical Conspiracy?*, 72 TEMP. L. REV. 251, 277 (1999).

113. *Id.*

114. Blair & Harrison, *supra* note 13, at 2.

115. As discussed *supra* text accompanying notes 104-105, OEMs could not afford to risk their relationships with Microsoft, so much so that OEMs did not support the government's case against Microsoft. In Texas, Dell Computer Corporation persuaded the state not to join the federal government's case. ROBERT W. HAHN, THE COSTS OF REGULATING MICROSOFT, SD72 ALI-ABA 93, 100 (1999).

116. 431 U.S. at 746.

117. *Id.*

B. Consumers Are Direct Purchasers

Precedent supports the district court's holding that the control exception to the direct purchaser rule does not apply to the relationship between Microsoft and OEMs. However, the plaintiffs also argued that consumers are direct purchasers because the EULA is the product. The court should have accepted this argument, particularly because it does not require any further exceptions to the direct purchaser rule, and there is no need to broaden the two exceptions created by the *Illinois Brick* Court. The argument that consumers are direct purchasers fairly characterizes software industry practices while removing the case from the purview of the *Illinois Brick* doctrine.

1. The Nature of the Software Industry

Transactions involving computer software differ from those involving ordinary goods because software transactions focus on the transfer of intangibles.[118] Most software transactions do not result in the transfer of title to the underlying software; rather, software manufacturers typically confer use rights to the software via license agreements.[119] The two most common types of license agreements are those between the software producer and the OEM, and those between the software producer and the end user.[120] The rights conferred by these two types of licenses are fundamentally different.

Microsoft distributes its software primarily through OEM licenses.[121] These OEM licenses run directly between Microsoft and the OEMs, and allow the OEMs to pre-install Microsoft software on PCs sold to end users.[122] The OEMs then sell the computer hardware containing the Microsoft software. Consumers receive computers with software preinstalled. Purchasing the computer does not automatically confer any rights to the software. Consumers cannot access the software until they enter into a license agreement with Microsoft. The fact that the software is pre-installed on the computer does not imply that consumers receive Microsoft's software as a free "bonus" when purchasing the computer. If the consumer

118. Raymond T. Nimmer, *License Contracts Under Article 2 of the Uniform Commercial Code: A Proposal.* 19 RUTGERS COMPUTER & TECH. L.J. 281, 283 (1993).

119. *Id. See also* IAN BALLON, E-COMMERCE AND INTERNET LAW § 21 (2001).

120. Nimmer, *supra* note 118.

121. Michael P. Akemann, *Microsoft's Licensing Agreements: Theory & Evidence on the Sale of MS-DOS & Windows*, 24 J. CORP. L. 553, 562 (1999).

122. *In re* Microsoft Corp. Antitrust Litig., 127 F. Supp. 2d 702, 706 (D. Md. 2001).

does not agree to the terms of the EULA, Microsoft will refund the money the consumer "paid" for the product.[123]

The EULA allows consumers to install and use the software on a single computer or multiple computers, depending on the terms of the license.[124] Microsoft grants the right to use the software on the PCs only to a specified number of end users.[125] The price of the EULA varies based on the number of operating systems that consumers may run concurrently.[126] Microsoft's EULA cannot be negotiated; consumers take it or leave it by clicking "I agree" on the computer or taking other actions to indicate acceptance of Microsoft's offer of license rights.[127]

Although both are license agreements, the OEM license and the EULA contain different terms and therefore have different values. The value of the software stems from the right to use the software; this value is transferred via the license agreement and will vary widely depending on the terms of the license. For example, the value of a license that allows 10 people to use the software will be considerably less than the value of a license that allows 10,000 people to use the software.[128] The tremendous difference in the value exists even though the "intrinsic value of the underlying software itself is unchanged."[129] In the most fundamental sense, the product is the thing that contains value. Therefore, in the software industry the license is the product. Robert Gomulkiewicz[130] argues that "[f]or most software products, the license is the product; the computer program provides functionality to the user, but the license delivers the use rights."[131] In fact, without software licenses "some [software] companies would have had no valid products at all."[132]

In the context of ordinary goods, it may seem strange to think of a contract or agreement as the product. However, transactions that involve the

123. *Id.*

124. Robert W. Gomulkiewicz, *The License is the Product: Comments on the Promise of Article 2B for Software & Information Licensing*, 13 BERKELEY TECH. L.J. 891, 921-922 (1998).

125. *In re Microsoft*, 127 F. Supp. 2d at 706.

126. *Id.*

127. *Id.*

128. *Controversial New Rules for Computer Contracts,* TECH. COMMENTARIES, (Jones, Day, Reavis & Pogue), May 2000, at 1.

129. *Id.*

130. Mr. Gomulkiewicz is a senior corporate attorney for Microsoft Corporation. We cannot doubt his disclaimer that the views expressed in his article are his own and not those of Microsoft.

131. Gomulkiewicz, *supra* note 124, at 896.

132. *Id.* at 897.

transfer of rights in software technology implicate issues that are fundamentally different from those in the sale of goods. In a case involving the sale of an ordinary good, such as a pencil, the value is in the good itself. It is difficult, if not impossible, to separate the good and the right to use the good. Pencil manufacturers do not sell the right to use their pencils; they sell the pencils. Software manufacturers, on the other hand, sell only the right to use their software.

Microsoft's own business practices indicate that the company treats the EULA as the product. The terms of the OEM license specifically state that the OEMs do not purchase or receive title to the end user rights to the software or to the EULA.[133] OEMs are simply allowed to install the Microsoft programs.[134] The terms of the EULA expressly state that it is between Microsoft and the end users, not between the end user and the OEM.[135] Finally, the EULA provides that Microsoft, not the OEM, will issue refunds to prospective end users who do not agree to the "take-it-or-leave-it" terms of Microsoft's EULA.[136]

Some commentators refer to these software licenses as a "legal fiction."[137] The software industry created the software license as a response to the lack of intellectual property protection for software.[138] In the late 1970s and early 1980s it was not clear that copyright or patent law would protect computer software.[139] As a result, computer programmers sought trade secret protection for their programs.[140] The software industry created the "legal fiction that they were licensing rather than selling their software" because they needed proof that they were not disclosing trade secrets by selling the software. The license required customers to keep the software confidential, thus the software became protectable.[141]

Although computer programs are now protectable by copyright and patents, the software industry continues to use the software license. The industry benefits from this "legal fiction" because licensing software, rather than selling it, gives software manufacturers more control over what consumers do with the software. For example, license agreements often

133. *In re Microsoft*, 127 F. Supp. 2d at 706.
134. *Id.*
135. *Id.*
136. *Id.*
137. Mark A. Lemley, *Intellectual Property & Shrinkwrap Licenses*, 68 S. CAL. L. REV. 1239, 1244 (1995).
138. *Id.*
139. *Id.* at 1243.
140. *Id.* at 1244.
141. *Id.* at 1245.

prohibit licensees from reselling, transferring, or assigning their particular copy of the software.[142] These provisions clearly "conflict with the 'first sale' doctrine in copyright law, which gives the owner of a particular copy of a copyrighted work the right to dispose of that copy without the permission of the copyright owner."[143] However, software manufacturers avoid the first sale doctrine by licensing their software rather than selling it.[144] The software industry therefore diligently promotes the idea that software is licensed, not sold. The software industry should be subject to all of the consequences of this arrangement, rather than just reaping the benefits. Along those lines, the court should have recognized that the EULA is the product and treated the end users as direct purchasers.

Support for the proposition that software is not sold extends beyond Microsoft and the software industry. While there is more debate outside the software industry, both courts and academics have accepted the argument that software is licensed, not sold. Microsoft has successfully argued in court that its software is licensed rather than sold, in order to preclude an infringer from relying on the first sale doctrine.[145] The strongest support, outside the software industry, comes from the drafters of the Uniform Computer Information Transactions Act ("UCITA").[146] The National Conference of Commissioners of Uniform State Laws ("NCCUSL") drafted UCITA because there was no uniform body of contract law that governed information industries.[147] Article 2 of the Uniform Commercial Code ("UCC") does not cover computer information because "[c]omputer information is not a good and is usually licensed, not sold."[148] That software is licensed, not sold, is a fundamental tenet of UCITA.

142. *Id.* at 1267.

143. *Id.*

144. *See id.* at 1273 (explaining that the House Committee Notes accompanying section 109(a) make it clear that parties can contract around the first sale doctrine and citing Notes of Comm. on the Judiciary, H.R. Rep. No. 94-1476, *reprinted in* 1976 U.S.C.C.A.N. 5659).

145. Microsoft Corp. v. Harmony Computers & Elecs., Inc., 846 F. Supp. 208, 212-13 (E.D.N.Y. 1994). *But see* Microsoft Corp. v. DAK Indus., 66 F3d 1091 (9th Cir. 1995) (holding that the economic realities of the agreement indicated a sale, not a license to use); Softman Products Co. v. Adobe Systems, Inc. 2001 WL 1343955 (C.D. Cal. Oct. 19, 2001) (concluding that software is sold, licensed).

146. *See* Raymond T. Nimmer, *Materials on UCITA: What Is It and Why Is So Much Misrepresented About the Statute?*, 670 PLI/PAT 591, 594 (2001).

147. *Id.*

148. *Id.*

2. *Application of the* Illinois Brick *Doctrine to the Software Industry*

The most important step in applying the *Illinois Brick* doctrine is correctly identifying the alleged monopoly product.[149] Identifying the product is critical because it is impossible to pinpoint the direct purchaser if one cannot identify the monopolized product.[150] There is a distinction between "goods" and "services" that cannot be ignored when attempting to identify the monopolized product. Goods are capable of being purchased and resold; however, in most cases services provide value only to the direct purchaser.[151] Once the service is provided it is consumed and cannot be transferred.[152] Therefore, there are very few scenarios in which it is possible to have an indirect purchaser of a service.[153]

Transactions involving software blend traditional elements of goods transactions with components involving intangible rights and services.[154] Software resembles traditional goods in that it is reusable; it is not "used up." Unlike goods, however, software is not purchased or sold—it is licensed. Software also has the characteristics of a service because it is intangible. While software often comes on a diskette or a compact disc, tangible media are often not necessary. Software can be transferred in intangible form, via the Internet, for example. In fact, once the software is installed, the diskette or compact disc is no longer necessary. The value conveyed in a software transaction is therefore independent of the tangible item involved.

The court in *Microsoft* mistakenly applied the *Illinois Brick* doctrine because it did not identify the product correctly. The court failed to recognize that computer software lies on the line between goods and services. Consumers do not purchase Microsoft's software, they purchase the right to the software. The value lies in the right to the software, and that value is transferred via the license agreements. The private suits against Microsoft involved two distinct products, the OEM license and the EULA. Each of these products had its own direct purchaser: the OEMs purchased the OEM license, and the end users purchased the EULA. Therefore, both OEMs and end users are direct purchasers of Microsoft's product.

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149. Kingsbury, *supra* note 2, at 488.
150. *Id.*
151. *Id.* at 489.
152. *Id.*
153. *Id.*
154. Nimmer, *supra* note 118, at 293.

IV. CONCLUSION

The court's application of the *Illinois Brick* doctrine to bar consumer suits against Microsoft is inconsistent with both policies underlying *Illinois Brick* and with software industry practices. One of the central goals of *Illinois Brick* was deterrence. The Court wanted to give the party with the most motivation to sue the right to sue. In the *Microsoft* case, the parties with the most motivation to sue are consumers, not OEMs. Unfortunately, courts have interpreted the control exception to the direct purchaser rule very narrowly, and so the *Microsoft* court held that the control exception did not apply in this case. While the court's decision undermines the goals of *Illinois Brick*, it is consistent with recent precedent. However, the court should have recognized the distinctive nature of the software industry and held that consumers are direct purchasers of Microsoft's product. Software licenses differ from the sale of traditional goods in two major ways. First, software licenses focus on intangibles and the right to use these intangibles. Second, software is licensed, not sold. The true value of the software is contained in the software license. Consumers are purchasing the right to use Microsoft's software. The EULA is therefore the product Microsoft is selling and consumers are direct purchasers of that product.