EXHIBIT 3

TO THE COMMENTS

OF RELPROMAX ANTITRUST INC.

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF THE DISTRICT OF COLUMBIA

UNITED STATES OF AMERICA, Plaintiff, v. MICROSOFT CORPORATION, Defendant.	)	Civil Action No. 94-1564 (SS) Competitive Impact Statement

Exhibit
comments
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COMPETITIVE IMPACT

Pursuant to Section 2(b) of the Antitrust Proce
(h), the United States submits this Competitive Impact
Judgment submitted for entry with the consent of defen
antitrust proceeding.

NATURE AND PURPOSE OF T

On July 15, 1994, the United States filed a civil antitrust Complaint to prevent and restrain Microsoft Corporation ("Microsoft") from using exclusionary and anticompetitive contracts to market its personal computer operating system software, in violation of Sections 1 and 2 of the Sherman Act, 15 U.S.C. §§ 1, 2. As alleged in the Complaint, Microsoft has used these contracts to restrain trade and to monopolize the market for operating systems for personal computers using the x86 class of microprocessors, which comprise most of the world's personal computers. As used herein, "PC" refers to personal computers that use this class of microprocessor.

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The Complaint alleges that Microsoft has used its monopoly power to induce PC manufacturers to enter into anticompetitive, long-term licenses under which they must pay Microsoft not only when they sell PCs containing Microsoft's operating systems, but also when they sell PCs containing non-Microsoft operating systems. These anticompetitive, long-term licenses have helped Microsoft to maintain its monopoly. By inhibiting competing operating systems' access to PC manufacturers, Microsoft's exclusionary licenses slow innovation, raise prices, and deprive consumers of an effective choice among competing PC operating systems.

The Complaint also alleges that in connection with pre-release testing of a new Microsoft operating system code-named "Chicago," Microsoft sought to impose unreasonably restrictive and anticompetitive non-disclosure agreements on a number of leading developers of applications software products. These non-disclosure agreements would have unreasonably restricted the ability of software developers to work with competing operating systems or to develop competitive products or technologies.

The Complaint seeks to prevent Microsoft from continuing or renewing any of the anticompetitive practices alleged to violate the Sherman Act, and thus to provide fair opportunities for other firms to compete in the market for PC operating systems.

The United States and Microsoft have agreed that the proposed Final Judgment may be entered after compliance with the Antitrust Procedures and Penalties Act.[1] Entry of the Final

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[1] The proposed Final Judgment that was filed with the Complaint on July 15, 1994 contained several omissions and inconsistencies in the numbering of paragraphs and sub-paragraphs. With the Defendant's consent, a corrected version of the Final Judgment is being filed with this Competitive Impact Statement. See Attachment. Paragraph and sub-paragraph numbers in this Competitive Impact Statement refer to the numbers used in the corrected version of the Final Judgment.

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Judgment will terminate this civil action, except that the Court will retain jurisdiction for further proceedings that may be required to interpret, enforce, or modify the Judgment, or to punish violations of any of its provisions.

DESCRIPTION OF THE PRACTICES INVOLVED IN THE ALLEGED VIOLATIONS

If this case were to proceed to trial, the United States would prove the following:

Microsoft develops, licenses, sells, and supports several types of software products for personal computers, including operating systems and applications. An operating system is software that controls the basic operations of the personal computer. Applications software, such as word processing programs and spread sheets, runs "on top of" an operating system to enable the computer to perform a broad range of useful functions. Operating systems are designed to work with specific microprocessors, the integrated circuits that function as the "brain" of the computer. Most of the personal computers in the world today use the x86 class of microprocessors, originally designed by Intel, and now including microprocessors manufactured by other companies that use a substantially similar architecture and instruction set. Original equipment manufacturers ("OEMs") that sell PCs and customers who buy such machines cannot use operating systems written for other microprocessors.

In 1981, Microsoft introduced a PC operating system called the Microsoft Disk Operating System ("MS-DOS"), the original version of which Microsoft licensed to IBM for use in IBM's PC. As IBM's PC experienced considerable commercial success, other OEMs also used MS-DOS in order better to emulate the IBM PC. In 1985, Microsoft introduced "Windows," a more sophisticated PC operating system product designed for use in conjunction with MS-DOS.

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Windows allowed users to give instructions with a "mouse" or similar device and also to run more than one application at a time. Microsoft quickly gained a monopoly in the market for PC operating systems worldwide. For almost a decade, Microsoft's market share has consistently exceeded 70%.[2]

Development, testing, and marketing of a new PC operating system involves considerable time and expense. A new operating system faces additional barriers to entry, including the absence of a variety of high quality applications to run on the system; the small number of people trained on and using the system, which discourages customers from buying it and software companies from writing applications to run on it; and, since the overwhelming majority of PCs are sold with a pre-installed operating system, the difficulty of convincing OEMs to offer and promote the system.

Microsoft has used exclusionary and anticompetitive contract terms to maintain its monopoly. OEMs believe that a substantial portion of their customers will want a PC with MS-DOS and Windows, and therefore feel that they must be able to offer their customers MS-DOS and Windows. With thin profit margins, OEMs want to obtain these products at the lowest possible cost.

Beginning in 1988, and continuing until July 15, 1994, Microsoft induced many OEMs to execute anticompetitive "per processor" licenses. Under a per processor license, an OEM pays

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[2] In 1993, Microsoft's MS-DOS operating system constituted approximately 79 % of the operating systems sold to PC manufacturers. PC-DOS accounted for approximately 13 % of such sales, OS/2 constituted approximately 4 %, DR-DOS constituted approximately 3 %, and Unix operating systems constituted approximately 1 %. A chart showing these market shares is attached as Exh. 1.

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Microsoft a royalty for each computer it sells containing a particular microprocessor, whether the OEM sells the computer with a Microsoft operating system or a non-Microsoft operating system. In effect, the royalty payment to Microsoft when no Microsoft product is being used acts as a penalty, or tax, on the OEM's use of a competing PC operating system. Since 1988, Microsoft's use of per processor licenses has increased. In fiscal year 1993, per processor licenses accounted for an estimated 60% of MS-DOS sales to OEMs and 43% of Windows sales to OEMs.[3] Collectively, the OEMs who have such per processor contracts are critical to the success of competing operating system vendors, but those OEMs effectively are foreclosed to Microsoft's competitors.

Microsoft has further foreclosed the OEM channel through the use of long-term contracts with major OEMs, some expiring as long as five years from their original negotiation date. In some cases, these contracts have left OEMs with unused balances on their minimum commitments, which Microsoft can allow to be used if the contract is extended, but which would be forfeited if the OEM does not extend the contract. These practices have allowed Microsoft to extend the effective duration of its OEM contracts, further impeding the access of PC operating system competitors to the OEM channel.

In addition to using anticompetitive OEM licenses, Microsoft has also employed anticompetitive restrictions in certain of its non-disclosure agreements ("NDAs"). Microsoft

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[3] Per processor licenses accounted for an increasing proportion of Microsoft's operating system sales in the 1988 - 1993 period. Twenty per cent of all units of MS-DOS that were sold to OEMs in FY 1989 were sold pursuant to per processor licenses. That percentage increased to 22 % in FY 1990; 27 % in FY 1991; 50 % in FY 1992; and to 60 % in FY 1993. A chart showing this increasing use of per-processor licenses is attached as Exh. 2.

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anticipates commercially releasing Chicago, the next version of Windows, in late 1994 or early 1995. In preparation for its release, Microsoft has allowed certain third parties, including independent software vendors ("ISVs") who write applications, to have access to pre-release versions of Chicago, a process known in the software industry as "beta testing." This permits Microsoft to receive feedback from the beta testers, and the ISVs to begin writing applications for Chicago prior to its release.

In connection with beta testing Chicago, Microsoft employed, as it has in prior beta tests, NDAs prohibiting disclosure of confidential information. In this instance, however, Microsoft sought to impose on certain leading software companies far more restrictive NDAs than it had previously used. These NDAs would have precluded developers from working on competitive products and technologies for an unreasonably long period of time.

Through these practices, Microsoft has excluded competitors by unreasonable and anticompetitive means, thereby lessening competition and maintaining a monopoly in the PC operating system market. Microsoft's licensing practices deter OEMs from entering into licensing agreements with operating system rivals and discourage OEMs who agree to sell non-Microsoft operating systems from promoting those systems. By depriving rivals of a significant number of sales that they might otherwise secure, Microsoft makes it more difficult for its rivals to convince ISVs to write applications for their systems, for OEMs to offer and promote their systems, and for users to believe that their systems will remain viable alternatives to MS-DOS and Windows.

Microsoft's exclusionary contracts harm consumers. OEMs that sign Microsoft's exclusionary licenses but offer consumers a choice of operating systems may charge a higher price, in order to cover the double royalty, for PCs using a non-Microsoft operating system.

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Even consumers who do not receive a Microsoft operating system still pay Microsoft indirectly. Thus, Microsoft's licensing practices have raised the cost of personal computers to consumers.

Microsoft's conduct also substantially lengthens the period of time required for competitors to recover their development costs and earn a profit, and thereby increases the risk that an entry attempt will fail. In combination, all these factors deter entry by competitors and thus harm competition. By deterring the development of competitive operating systems, Microsoft has deprived consumers of a choice of potentially superior products. Similarly, the slower growth of competing operating systems has retarded the development of applications for such systems.

EXPLANATION OF THE PROPOSED FINAL JUDGMENT

The proposed Final Judgment will end Microsoft's unlawful practices that restrain trade and perpetuate its monopoly power in the market for PC operating systems. In addition, the proposed Final Judgment contains provisions that are remedial in nature and designed to assure that Microsoft will not engage in the future in exclusionary practices designed to produce the same or similar effects as those set forth in the Complaint.

In particular, Sections IV (A), (C), and (F) prohibit Microsoft's use of the specific exclusionary practices alleged in the complaint -- "per processor" contracts, lengthy terms, and minimum commitments -- that foreclose competing PC operating system vendors from much of the OEM channel. Sections IV (K)-(L) prohibit the use of anticompetitive non-disclosure agreements in conjunction with Microsoft's distribution of pre-commercial releases of operating system software products. Sections IV (B), (E), (G), and (H) impose prohibitions that go beyond the alleged exclusionary practices in order to ensure that Microsoft's future contracting practices -

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- not challenged here because not yet used -- do not unreasonably impede competition. Sections IV (J) and (M) are designed to bring existing contracts into immediate compliance with the proposed Final Judgment.

Scope of the Final Judgment

The injunctions in Section IV generally apply to "covered products" which are defined, in Section II (A), as the binary code of MS-DOS 6.22; Microsoft Windows 3.11; Windows for Workgroups 3.11; predecessor versions of those products; the product currently code-named "Chicago" (the planned successor to Microsoft Windows 3.11); and other successor versions of or products marketed as replacements for the aforementioned products. This definition includes all Microsoft's PC operating system products in which the defendant currently possess a substantial degree of market power. The definition does not encompass, and specifically excludes, Windows NT Workstation and Windows NT Advanced Server, neither of which has a significant share of a relevant market at this time.

The definition of "covered product" was drafted with the recognition that Microsoft will continue to modify its operating system products throughout the duration of the Final Judgment. The prohibitions in the decree will apply to the successor and replacement products of those existing operating system products that have substantial market power. The decree will govern the licensing of such products if they are made available as stand-alone products to OEMs pursuant to license agreements, or as unbundled products that perform operating system software functions now embodied in the specifically listed existing products. Moreover, the decree will govern the licensing of successor versions of or products marketed as replacements for MS-DOS 6.22, Microsoft Windows 3.11, Windows for Workgroups 3.11, and "Chicago,"

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even if such successor or replacement products could also be characterized as successors or replacements of operating system software products that are not covered, such as Windows NT Workstation or Windows NT Advanced Server.

Prohibition of the Licensing Violations

The three anticompetitive features of Microsoft's license agreements that are challenged in the complaint -- the excessive duration of those agreements, the requirement of royalty payments on a "per processor" basis, and large minimum commitments -- are addressed principally in Sections IV (A), IV (C) and IV (F) of the Final Judgment.

Duration: Section IV (A) limits the duration of Microsoft's license agreements with OEMs to one year, with OEMs having the option to renew a license for one additional one year term on the same terms and conditions as in the first year. This limitation on the duration of license agreements, along with the safeguards provided in Section IV (G), will ensure that vendors of competing operating systems will have regular and frequent opportunities to attempt to market their products to OEMs. Absent such opportunities, Microsoft's competitors might be unable to reach the level of market penetration needed for profitable operation in a reasonable period of time, even if they are offering products that are deemed superior by those customers who have an opportunity to buy them.

Per Processor Licenses: Section IV (C) prohibits the use of per processor licenses.[4] Section II (K) defines per processor licenses as licenses that require the OEM to pay a royalty for

[4]Section IV (J) (1) converts all per processor licenses to per system licenses, except those models which an OEM excludes, which will thereafter be subject to the limitations imposed on Microsoft by Section IV (G).

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all personal computer systems that contain specified microprocessors. As noted above, the requirement to pay a royalty to Microsoft on the sale of a PC that has a non-Microsoft operating system is comparable, in its economic effect, to the imposition of a "tax" on the competing operating system. Per processor licenses are also very similar to exclusive dealing or requirements contracts; the OEM in effect is obtaining the right to use Microsoft's operating system, and is paying an operating system royalty, for all of its operating system "requirements" for use on PCs using the designated microprocessors.

Minimum Commitments: Section IV (F) will bar Microsoft from entering into any license agreement containing a minimum commitment.[5] While minimum commitments are not in and of themselves illegal, they can be used to achieve a similar effect as that accomplished through per processor licenses or exclusive dealing contracts. If the minimum commitment is greater than the number of units of Microsoft software that the OEM expects or would otherwise desire to use at any time during the term of the contract, the minimum commitment creates a disincentive for an OEM to make incremental purchases of non-Microsoft operating systems. In that context, the minimum commitment also operates in effect to require a royalty payment to Microsoft, even for PCs that use a non-Microsoft operating system. This effect will be ended by Section IV (F).

Restoring Competition To The Market Through Prophylactic Additional Relief

The proposed Final Judgment not only bans Microsoft's unlawful practices, but also contains additional provisions which are prophylactic in nature, and are intended to ensure that

[5] Section IV (J) (2) prohibits Microsoft from prospectively enforcing minimum commitments in existing license agreements.

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the anticompetitive effects of those practices are not replicated through use by Microsoft of other exclusionary practices.

Microsoft Prohibited From Limiting OEM Sales of Competing Operating System Products: Section IV (B) bars Microsoft from entering into license agreements that prohibit or restrict an OEM from licensing, selling, or distributing competing operating system products. In addition, Section IV (E) prohibits Microsoft from expressly or impliedly conditioning its licenses of operating systems on the licensing, purchase, use or distribution not only of other covered products, but also any other Microsoft product, or non-Microsoft product. Without these provisions Microsoft could force OEMs to purchase covered products and thus accomplish anticompetitive effects similar to those achieved through its unlawful licensing practices, or attempt to extend or protect its monopoly in any covered product by conditioning its licenses on the licensing, purchase or use of other products.

Microsoft Limited to Per Copy and Per System Licenses: Sections IV (D) and IV (G) require Microsoft to use either "per copy" or "per system" licenses. Per copy licenses, if used in conjunction with pro-competitive volume discounts, pose few competitive concerns. Per system licenses, if not carefully fenced in, could be used by Microsoft to accomplish anticompetitive ends similar to "per processor" licenses. However, if an OEM easily can designate models not subject to a per system license, it can use non-Microsoft operating systems on those models without incurring a royalty obligation to Microsoft. If an OEM need not pay a royalty to Microsoft for anything but the number of copies of the Microsoft operating system that it actually uses, that OEM will not be deterred from licensing, purchasing or using competing operating system products.

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Restrictions on Per System Licenses: The Final Judgment also places restrictions on the use of per system licenses to ensure that they are not used in an exclusionary manner. In particular, Section IV (G) specifies that per system licenses must allow the licensee to create "new systems" that can be sold without incurring a royalty obligation to Microsoft if they do not utilize a Microsoft product. Under Section IV (G), an OEM need only designate a new model name or number to create a "new system." Microsoft may not require the OEM even to notify Microsoft of the creation of a new system; nor may Microsoft impose requirements relating to the marketing or advertising of a new system, or penalize an OEM for creating a new system. Section IV (G) (4) requires Microsoft to notify within 30 days following entry of this Final Judgment all existing OEM licensees under per system licenses and all OEM licensees with per processor licenses who choose to let them be converted to per system licenses (a provision discussed below) of their rights to create new systems that will not be subject to any existing per system license. This notice provision ensures that existing licensees promptly know of their rights to avoid royalty payments under per system contracts if they choose to create new systems.

Microsoft Prohibited From Using Lump Sum Pricing: Section IV (H) also serves a prophylactic function, prohibiting the use of lump sum pricing in license agreements for covered products. As defined in Section II (F), lump sum pricing is any royalty payment that does not vary with the number of copies of the covered product (under per copy licenses) or the number of personal computer systems (under per system licenses) that are licensed, sold, or distributed by the OEM. This restriction, like the prohibitions on minimum commitments and requirements

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contracts, restricts conduct that could be used by Microsoft to achieve effects comparable to the effects of the conduct challenged by the government, and for that reason is enjoined.[6]

Neither Section IV (H) nor any other provision of the proposed Final Judgment prohibits the use of royalty rates, including rates embodying volume discounts, agreed upon in advance with respect to each individual OEM, each specific version or language of a covered products, and each designated personal computer system model. Nothing in the Final Judgment, however, in any way sanctions Microsoft structuring any volume discount whose purpose or effect is to impose de facto requirements contracts or exclusive arrangements on the OEM. As discussed below in connection with alternatives to the proposed Final Judgment, given Microsoft's monopoly power in operating systems, such practices can violate the antitrust laws.

Transition Rules

In the Stipulation consenting to the entry of the proposed Final Judgment, Microsoft agreed to abide by the provisions of the proposed Final Judgment immediately upon the filing of the Complaint, i.e., as of July 15, 1994. Among other things, the transition provisions described herein will require Microsoft to abide by the foregoing limitations and prohibitions when entering

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[6] If a license agreement established a minimum commitment greater than the OEM's requirements for operating systems (an agreement that would be prohibited under this decree), the minimum commitment would constitute, in effect, a lump sum payment. Regardless of the number of copies distributed by the OEM, its royalty payment to Microsoft would not vary. A lump sum pricing arrangement imposed by a monopolist that allowed unlimited use of the licensed product for a single fee calibrated to the anticipated total operating system needs of a particular OEM would also produce a similar economic effect as a requirements contract or a per processor license: the OEM would owe the same royalty to Microsoft whether it chose to use a Microsoft operating system on all of the PCs it sold, or only on some of the PCs it sold, and would, in effect, "pay twice" if it chose to purchase a non-Microsoft operating system for some of its PCs.

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into any license agreements with OEMs after July 15, 1994. Certain additional provisions of the proposed Final Judgment also apply to existing license agreements that are inconsistent with the proposed Final Judgment's requirements for new license agreements.

Under Section IV (I), existing OEM licensees may terminate or negotiate with Microsoft to amend their agreements to make them consistent with the requirements of the Final Judgment.

Section IV (J) provides that if an OEM chooses not to exercise either of these options, Microsoft must abide by the following rules. First, under Section IV (J) (1), a per processor license must be treated as a "per system" license; OEM models that contain the microprocessor(s) specified in such a per processor license will be considered to be covered by the "per system" license unless the OEM opts in writing to exclude such model from coverage. As already noted, OEMs may freely sell PCs with non-Microsoft operating systems, and avoid any obligation to pay royalties to Microsoft under a per system license, simply by designating such PCs as a new system with a separate model number or name. Second, under Section IV (J) (2), Microsoft may not enforce any minimum commitment in an existing license agreement.

These provisions further two consistent goals. Opportunities for competition in the PC operating system market are fostered by a rapid end to the unlawful practices embodied in existing licenses. At the same time, the transition rules avoid creating hardships for OEMs by not unnecessarily disrupting established commercial relationships with Microsoft. Indeed, OEMs are not required to terminate or amend their existing contracts with Microsoft; the choice to do so is theirs alone. Microsoft, however, may not enforce the per processor or minimum commitment features of any existing contract. Providing OEMs with this choice minimizes the costs of the

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transition from existing license agreements that are inconsistent with the decree to new license agreements, while ensuring that any unavoidable transition costs be borne largely by Microsoft.

To ensure that existing licensees learn of their rights under the proposed Final Judgment, Section IV (M) requires Microsoft to provide a copy of the Final Judgment to all OEMs with which it has license agreements, except for those who have licenses only under Microsoft's Small Volume Easy Distribution program or the Delivery Service Partner program.

Non-Disclosure Agreements

Finally, the proposed Final Judgment contains provisions that prevent Microsoft from imposing unlawfully restrictive NDAs on developers of applications software.

Sections IV (K) (1) limits the duration of any NDA to the earliest of (a) the commercial release of the product covered by the NDA, (b) an earlier public disclosure of the information covered by the NDA, or (c) one year after the information is disclosed to the person subject to the NDA. Section IV (K) (2) provides that NDAs may not restrict subject parties from developing software products that will run on competing operating systems, if such development does not entail the use or disclosure of Microsoft proprietary information during the term of the NDA.

In combination, these provisions recognize that whatever Microsoft's legitimate interest in protecting the confidentiality of proprietary information covered by the NDAs, the need for any such protection must be balanced against the competitive consequences of any restriction imposed on others concerning disclosure and use of the information. The proposed Final Judgment ensures that any NDA imposed by Microsoft will not extend beyond the point that the

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requirements of the Antitrust Procedures and Penalties Act have been satisfied. The Court then must determine whether the proposed decree is in the public interest, pursuant to Section 5 (e) of the Clayton Act, 15 U.S.C. § 16 (e).[7]

ALTERNATIVES TO THE PROPOSED FINAL JUDGMENT

In addition to the remedies provided in the proposed Final Judgment, the Department also considered whether to require limitations on the manner in which Microsoft could structure volume discount pricing arrangements for covered products. While the Department recognizes that volume discount pricing can be and normally is pro-competitive, volume discounts also can be structured by a seller with monopoly power (such as Microsoft) in such a way that buyers, who must purchase some substantial quantity from the monopolist, effectively are coerced by the structure of the discount schedule (as opposed to the level of the price) to buy all or substantially all of the supplies they need from the monopolist. Where such a result occurs, the Department believes that the volume discount structure would unlawfully foreclose competing suppliers from the marketplace -- in this case, competing operating systems -- and thus may be challenged.

The Department ultimately concluded that it would not require provisions in the Final Judgment to attempt to proscribe in advance the various means by which Microsoft could

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[7] In making this public interest determination, "[t]he balancing of competing social and political interests affected by a proposed antitrust consent decree must be left, in the first instance, to the discretion of the Attorney General. The court's role in protecting the public interest is one of insuring that the government has not breached its duty to the public in consenting to the decree. The court is required to determine not whether a particular decree is the one that will best serve society, but whether the settlement is `within the reaches of the public interest.'" United States v. Bechtel Corp., 648 F.2d 660, 666 (9th Cir.), cert. denied, 454 U.S. 1083 (1981) (citations and internal quotations omitted). Accord United States v. Western Electric Co., 993 F.2d 1572, 1576 (D.C. Cir. 1993); United States v. American Tel. and Tel. Co., 552 F. Supp. 131, 151 (D.D.C. 1982), aff'd sub nom. Maryland v. United States, 460 U.S. 1001 (1983).

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attempt to structure volume discounts as a means to thwart competition rather than as a means of promoting competition. The Department reached this conclusion because it does not have evidence that Microsoft has, to date, in fact structured its volume discounts to achieve anticompetitive ends. The Department did, however, communicate to Microsoft its concern and stated its intent to initiate an investigation and antitrust enforcement proceeding, if warranted, should Microsoft adopt anticompetitive volume discount structures in its future license agreements. Given the procompetitive impact of the provisions of the proposed Final Judgment, the normally procompetitive nature of volume discount pricing, and the absence of any evidence that Microsoft has used volume discounting in an anticompetitive manner to date, the Department believes that this resolution is appropriate on the record at this time.

Another alternative to the proposed Final Judgment would be a full trial of this case. The Department of Justice believes that such a trial would involve substantial cost to the United States and is not warranted since the proposed Final Judgment provides all of the relief that the United States seeks in its Complaint and includes substantial additional prophylactic measures as well.

DETERMINATIVE MATERIALS AND DOCUMENTS

No materials or documents of the type described in Section 2(b) of the Antitrust

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Procedures and Penalties Act, 15 U.S.C. § 16(b), were considered in formulating the proposed Final Judgment.

Dated: July 27, 1994

Respectfully submitted,

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