

**UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MARYLAND**

IN RE MICROSOFT CORP.
ANTITRUST LITIGATION

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MDL Docket No. 1332
Hon. J. Frederick Motz

This Document Relates To:
All Actions.

**MEMORANDUM FOR THE COURT BY THE
SOFTWARE & INFORMATION INDUSTRY ASSOCIATION**

Of Counsel:

Glenn B. Manishin
Stephanie A. Joyce
Kelley, Drye & Warren LLP
1200 19th Street, N.W., Suite 500
(202) 955-9890
(202) 955-9792 fax

Ken Wasch, President
Software & Information Industry
Association
1090 Vermont Avenue, N.W., 6th Floor
Washington, DC 20005
(202) 789-4440
(202) 289-7097 fax

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The Software & Information Industry Association (“SIIA”), by its attorneys and in response to the Court’s invitation for comment, respectfully submits this Memorandum for the Court in opposition to the settlement agreement proposed by Microsoft and counsel for the so-called “Nationwide Settlement Class.” *See* Settlement Agreement (filed Nov. 19, 2001) (hereafter “settlement” or “proposed settlement”).

INTRODUCTION AND BACKGROUND

As SIIA outlined in its prior letter to the Court,¹ the proposed settlement is not an adequate remedy for the serious antitrust claims presented by the plaintiffs in these consolidated treble damages actions and would exacerbate the very monopolization issues that lie at the heart of the complaint in this case. Also, despite its evident charitable purposes, the actual effect of the proposal would be to limit long-term choice for educators, not adequately meet the pressing technology needs of students and teachers, and in all likelihood create largely offsetting new challenges for the eligible districts receiving benefits.

In essence, class counsel have proposed that the plaintiffs receive *nothing* directly as a result of this settlement. This shift of financial benefit from the class plaintiffs to third parties

raises serious questions under Rule 23 and requires the Court to closely scrutinize the settlement proposal to ensure that, in light of the scope of potential recovery at trial and the size of the plaintiff class, the choice and specific operating provisions of a charitable foundation vehicle is appropriate.

The Court's duty in reviewing a proposed class action settlement is not only to determine whether the proposal is "fair, reasonable and adequate" for the class under Federal Rule 23(e), Fed. R. Civ. P. 23(e), but also to ensure that the settlement does not affirmatively injure third parties or violate settled public policy. Because as presently structured it would permit Microsoft to extend its monopoly into a unique market, namely educational software, the settlement contradicts the overriding public policies of this nation's antitrust laws. It would be inexcusable for this Court to accept as a compromise a settlement that aggravates the precise monopolization problems that gave rise to this litigation in the first instance. A charitable foundation approach may be appropriate in this case, but it should not exacerbate the monopolization conduct alleged by the plaintiffs and should be properly fashioned to encourage and enable local educators to make computer, software and related choices in the technology and vendor-neutral environment necessary for effective implementation of learning technologies.

SIIA is the principal trade association of the software code and digital content industry, with 800 members operating globally. Our members develop and market software and electronic content for business, education, consumers and the Internet. SIIA's membership is comprised of large and small software companies, e-business and information companies, as well as many other traditional and electronic commerce companies of varying sizes.

Among SIIA's key public policy issues is the promotion of competition in the software industry. See "SPA's Competition Principles" as adopted by the SPA Board of Directors, Jan.

¹ Letter from Ken Wasch, President, SIIA, to Hon. J. Frederick Motz (Nov. 21, 2001).

30,1998, at <http://www.siiia.net/sharedcontent/govt/issues/compete/principles.html>. (SPA is a predecessor organization to SIIA.). SIIA has promoted these principles of competition in a variety of forums, including the federal courts. *See, e.g.*, Brief on Remedy of Amici Curiae Computer and Communications Industry Association and Software & Information Industry Association, *United States v. Microsoft*, Case No. 98-1232 (filed May 19, 2000); Brief of Software & Information Industry Association and Computer and Communications Industry Association As Amici Curiae Supporting Jurisdiction, *Microsoft Corp. v. United States*, Case No. 00-139 (filed Aug. 15, 2000).

SIIA is also a recognized leader in promoting effective utilization and application of technology in a variety of education settings, ranging from K-12 to higher education to life-long learning. In pursuing this policy, SIIA believes a two-pronged approach is necessary. *First*, it is essential to focus national investment in the general areas of education and workforce development. Our goal should be to develop the knowledge and technological skills of students and workers to ensure they are well prepared for the high-tech job market and contribute to the information economy.

Second, a student's overall educational achievement, as well as technology skills, can be enhanced when taught about and through technology. Effective utilization of technology in all aspects of the K-12, postsecondary and life-long learning process will help maximize opportunities for both student achievement and high performance worker output and begin to bridge the information technology skills gap. A cornerstone of national policy in this area must be sustained investment in integrating modern technology, including educational software and digital content, Internet-ready hardware and telecommunications, into teaching, training and

learning. SIIA has long promoted the goal of providing such investment unfettered by restrictions that limit the flexibility of educators to meet their unique technology needs and goals.

Judged against these objectives, the settlement proposed to the Court, while clearly well-intentioned, is inadequate to provide substantial technology benefits to American educators.

ARGUMENT

I. THE PROPOSED SETTLEMENT IS NOT AN ADEQUATE REMEDY FOR THE CLASS AND VIOLATES CORE UNITED STATES ANTITRUST PUBLIC POLICY

The proposed settlement seeks to resolve the consumer class action claims against Microsoft without offering any compensation to the plaintiff consumers. A third-party beneficiary solution may, in fact, be the appropriate remedy. Careful scrutiny by the Court is especially needed, because, as both a legal and a public policy matter, the proposal submitted for consideration fails to address Microsoft's systematic anticompetitive conduct in software licensing and distributing as well as the substantial harm that this conduct wrought on the plaintiff class. Not only does the settlement deny recovery to the plaintiff class, but it permits and even invites further monopolization of the software market by Microsoft. Thus, in accordance with Fourth Circuit precedent on Rule 23 settlements as well as the significant public policy issues raised in this case, the Court should carefully scrutinize the proposal and explore alternatives (including major adjustments to the proposed settlement) that could meet the settled legal and policy functions of class action settlements and the well-intentioned education goals of the proposed settlement.

A. The Proposed Settlement Is Neither Fair Nor Adequate as Required In Class Actions

Any proposed settlement in a class action requires the approval of the trial court. Fed. R. Civ. P. 23(e). Class action settlements will be approved where they are deemed "fair, reasonable

and adequate” for the class. *In re Mid-Atlantic Toyota Antitrust Litigation*, 605 F. Supp. 440, 442 (D. Md. 1984) (*quoting* Manual on Complex Litigation § 1.46 at 56-57 (5th ed. 1982)). The Fourth Circuit has consistently applied this standard through a two-part test: first, as to fairness, courts will review the settlement process itself to assess “the presence or absence of collusion among the parties;” and secondly, as to adequacy, courts will “weigh the likelihood of the plaintiff’s recovery on the merits against the amount offered for settlement.” *In re Montgomery County Real Estate Antitrust Litigation*, 83 F.R.D. 305, 315-16 (D. Md. 1979).

The fairness inquiry is aimed principally at addressing “the danger of counsel’s compromising a suit for an inadequate amount for the sake of insuring a fee.” *Id.* at 315. To ensure that such conduct is not rewarded with settlement, courts will examine the length and scope of the settlement process as to whether it reflects good faith, arms-length negotiations. *Mid-Atlantic Toyota*, 605 F. Supp. at 443.

The issue of adequacy generally requires that, where plaintiffs are likely to obtain favorable judgment on the merits, the class members recover relief that approximates the potential final judgment. *Id.* at 444; *Troncelliti v. Minolta Corp.*, 666 F. Supp. 750, 754 (D. Md. 1987). Settlement relief is considered adequate if “the amount received by each [class member] will compensate those consumers for their actual loss.” *Troncelliti*, 666 F. Supp. at 754 *See also Mars Steel Corp. v. Continental Illinois National Bank and Trust Co.*, 834 F.2d 677, 682 (7th Cir. 1987) (settlement is adequate “if it gives [plaintiffs] the expected value of their claim if it went to trial”). For example, this Court has approved settlements in civil antitrust class actions for price fixing in which each member received an amount approximating the difference between the retail price and a competitive price. *Mid-Atlantic Toyota*, 605 F. Supp. at 444; *Troncelliti*, 666 F.

Supp. at 751. What is implicit in these decisions is that the relief bears a reasonable relation to the conduct alleged and the relief sought.

In this case, the remedy proposed in the settlement bears little semblance to the relief sought by the class. The class is comprised of software consumers – individuals, small companies and other parties – who allege that they have paid “artificially high prices” for Microsoft software as a result of Microsoft’s anticompetitive licensing practices and predatory conduct. Complaint ¶ 2. The class sought relief in the form of actual and treble damages for their alleged overpayment as well as injunction of the anti-competitive conduct alleged. Complaint at 64-65. The settlement, however, provides for the formation of a charitable foundation funded by Microsoft and the donation of software, refurbished computers and related support to public schools attended by low-income children. Settlement Section IV.2, Section IV.5–6. The class members themselves do not recover any damages, even in the “coupon” form (*i.e.*, discounts on future purchases) that have become all too common in modern class action settlements.

In reviewing the adequacy of a settlement, the Court takes on a fiduciary duty to protect the interests of the class members. *E.g.*, *Thomas v. Albright*, 139 F.3d 227, 233 (D.C. Cir. 1998); *Grant v. Bethlehem Steel Corp.*, 823 F.2d 20, 22 (2d Cir. 1987); *In re Matzo Food Products*, 156 F.R.D. 600, 604, 1994 U.S. Dist. LEXIS 11101, at *11-12. This duty requires the court to ensure that class counsel has crafted a settlement that “is fair and not a product of collusion, and that the class members’ interests have been represented adequately.” *Grant*, 823 F.2d at 22. Thus, where class members receive no modicum of the monetary or injunctive relief they sought, courts are empowered to reject a settlement even where the plaintiff class was not necessarily

assured of prevailing on the merits. *See, e.g., Berry v. School District of the City of Benton Harbor*, 184 F.R.D. 93, 1998 U.S. Dist. LEXIS 20917, *43 (W.D. Mich. 1998).

In situations where the class plaintiffs recover nothing but class counsel receives significant legal fees for minimal litigation activities, courts have undertaken a more searching inquiry into whether counsel here have “compromis[ed] a suit for an inadequate amount for the sake of insuring a fee.” *In re Montgomery County Real Estate Antitrust Litigation*, 83 F.R.D. at 315-16.

SIIA recognizes the spirit of advancing educational technology that underlies the settlement proposal, but we are deeply concerned, as addressed below, that the specific provisions of the proposal not only aggravates Microsoft’s monopoly power, but will actually diminish the long-term technology options available to America’s educational community. Some of these deficiencies might have been avoided had there been a more open and transparent opportunity for education experts to help fashion the settlement. The inappropriate “lock in” of Microsoft technology that will inevitably result from a widespread, unchallenged distribution of Microsoft software to schools is therefore inherent in the proposal and can be rectified only if the structure and provisions of the proposed remedy and its Foundation are substantially modified.

B. The Settlement Fails to Address, and in Fact Exacerbates, the Core Allegations of Anticompetitive Conduct By Microsoft

The Court has an obligation to consider the public policy implications of a class action settlement. *Levell v. Monsanto Research Corp.*, 191 F.R.D. 543, 557-559, 2000 U.S. Dist. LEXIS 1746, *46-48 (S.D. Ohio 2000); *Berry*, 1998 U.S. Dist. LEXIS 20917, *43. Although speedy resolution of litigation is often consistent with the public interest, settlements that contravene significant, overarching matters of policy may nonetheless not be approved. *See Berry*, 184 F.R.D. at 106. For example, the court in *Berry*, in reviewing a settlement of a class

action alleging segregation by Benton Harbor schools, paid close attention to the proposed injunctive relief to ensure that further discrimination would not go unchecked. *Id.* Further, where, as here, the proposed settlement establishes a trust but provides no direct relief to the plaintiff class, courts will provide even closer scrutiny of the public policy implications of the trust itself. *In re Real Estate Antitrust Litigation*, 83 F.R.D. at 319.

In this particular case, the facts are clear: Microsoft has been judged to have unlawfully monopolized the desktop operating system (“OS”) market in violation of Section 2 of the Sherman Act, 15 U.S.C. § 2. That liability judgment has been affirmed unanimously by an *en banc* Court of Appeals. *United States v. Microsoft*, 253 F.3d 34 (D.C. Cir. 2001) (“*Microsoft III*”). The judgment estops Microsoft from raising defenses in this action to any claim substantially similar to the monopolization count affirmed by the D.C. Circuit. *Theater Enterprises v. Paramount Film Distributing Corp.*, 346 U.S. 537 (1954); *Webster Rosewood Corp. v. Schine Chain Theaters*, 263 F.2d 533 (2d Cir. 1959). The proposed settlement, however, permits Microsoft not only to ignore the judgment against it, but also to persist in the conduct underlying the finding of unlawful monopolization. Indeed, the proposal curiously offers Microsoft an opportunity to advance its operating system monopoly into a separate retail market that it does not currently dominate.

Antitrust remedies in government suits must eliminate the “fruits” of monopoly and foreclose defendants from continuing their anticompetitive conduct. *Ford Motor Co. v. United States*, 405 U.S. 562, 577 (1972). Though this is a civil suit, the same general goal should obtain, lest the government’s work in the federal suit go to naught. *E.g.*, *United States v. GTE Corp.*, 603 F. Supp. 730 736 (D.D.C. 1984) (approving consent decree for GTE modeled on AT&T divestiture). Indeed, plaintiffs’ initial intent in this case was to rely on the sound

foundation of the Department of Justice's monopolization claim as the fulcrum for obtaining price relief. *See* Complaint ¶¶ 9-16 ("Government Action"). Having invoked the government's successful efforts in securing a finding of Microsoft's antitrust liability, *Microsoft III*, 253 F.3d at 375, plaintiffs' counsel cannot now ask the Court to ignore that finding.

The proposed settlement, however, in no way addresses the exclusionary, discriminatory and punitive acts that Microsoft was adjudged to have committed. Rather, it allows Microsoft to leverage its proven OS monopoly to the educational market by granting it relatively *unfettered discretion* to provide the software, training, and maintenance services to eligible schools in a Microsoft or Microsoft-related form. Settlement Sections IV.3 and IV.6. Provisions suggesting the settlement will provide software and related products and services from other vendors, which will often be the preference of educators, are wholly inadequate in their effect. For example, the provision of both training and technical support are subject to Microsoft's influence and financial control, and the refurbished computers will be made available with Microsoft Windows OS. Moreover, estimates show more than one-half the settlement value is contained within the provision for free Microsoft software.

In allowing such anticompetitive conduct to continue, the proposed settlement will dramatically affect the market dynamics of educational software, technology and services. It will enable Microsoft to gain market access relative to its competitors, eliminate competition, and thus leverage its monopoly into the K-12 education market. As a result, teachers will have a reduced choice in software and the children in these schools will have lost the opportunity for exposure to products other than Microsoft's, as some commenters have already cautioned.² The proposed settlement, as presented to the Court, should at the very least be modified in order to

eliminate any direct or indirect Microsoft advantages in the way of promotion, subsidy or favor. Such modification will safeguard the ability of educators to unconditionally make for themselves the crucial choices regarding computer technology for American schools.

II. THE PROPOSED SETTLEMENT WOULD DISTORT THE EDUCATIONAL SOFTWARE MARKET AND IS NOT IN THE BEST INTERESTS OF AMERICAN SCHOOLS AND MUST BE CORRECTED

At first blush, the proposed settlement would appear to be an act of good works to enable technology to reach those who might otherwise be unable to take advantage of computer hardware, software and training in an educational setting. The overwhelming response received so far by this Court suggests otherwise.

A careful examination of the proposal reveals that the charitable assumptions underlying the proposed settlement are strikingly different from reality. Even if the settlement could meet the legal standards outlined above, its practical import would be detrimental to education technology policy goals in the United States unless significant changes are made.

The detrimental impact is twofold. First, as outlined above, the settlement proposal would provide Microsoft with a competitive advantage in the education market that would ultimately reduce the number of competing companies, products and services available to educators. The settlement's promotion and subsidization of Microsoft products and services would limit market opportunities for Microsoft competitors and competitors of Microsoft education partners. In the highly competitive and stratified school technology market, the elimination of competition for even a few large customers, such as those who will most benefit from the settlement, will have a disproportionate impact on the marketplace. As a result, certain

² See, e.g., Letter from Classroom Connect (Nov. 22, 2001); Letter from Association of Educational Service Agencies (Nov. 23, 2001); Letter from D. Thomas King, Ph.D. (Nov. 25, 2001); Letter from Mississippi Dept. of Education (Dec. 5, 2001).

vendors focused on this segment of the education market would face severe economic pressures, including the possibility of being forced to close their operations.

Second, the most disadvantaged schools targeted for benefit would be especially and most directly restricted in their future choices and ability to achieve effective technology implementation. The proposed settlement is not consistent with the well-established principle that technology investment must be both based on a long-term local strategy and plan as well as provide school decision-makers with the flexible resources to meet these unique needs and goals. Instead, it risks simply “throwing technology” at schools that may be both ill-prepared to accept and integrate these prescribed technology solutions and may in fact face short and long-term direct and opportunity costs that divert them from meeting their specific student and classroom needs. Substantial changes in the proposed settlement are necessary to ensure the nation's poor schools have the same opportunity and choice to accommodate their technology needs as their more affluent neighbors.

As proposed, Microsoft would provide its own software for computers “used for instructional purposes.” There is, in fact, a great deal of software that has been developed specifically for schools and tested in the classroom and educational settings beyond those created by Microsoft. Some of this is used through desktop computers and some is accessed through online portals via the Internet. As others have noted:

To be of real benefit in schools, the software selected must directly support teaching and learning of defined curriculum objectives; it must integrate well and enhance the work of other learning activities, since the software will be only one component of the instructional program; it must be easy to use by teachers and by students at the targeted grade levels; and it must fit the classroom context in which, for example, students may share computers,

work in small groups, and have short time periods available on the computers.³

The specifics provided in the settlement proposal are not consistent with this need as confirmed by the experience of our industry in working with schools districts and educators over many years.

A few of the titles mentioned in relation to the settlement are designed for education purposes and are, in fact, being used in some schools.⁴ But personal productivity applications (PPAs), such as Microsoft Office, are not software designed for instructional purposes in the classroom. Ultimately, again based on our industry's experience and research-proven practice, the key challenge is to work with schools districts and educators to identify and integrate appropriate software and hardware resources that meet specific needs. There are many such products on the market from a variety of vendors that can meet the range of educator needs. This proposal does far too little to assist educators in acquiring these resources.

The practical result of this proposal's failure to adequately assist eligible schools in implementing their true learning technology needs will, in all likelihood, be both a failure to maximize the total investment and an unnecessary and disruptive diversion of existing and limited school resources. In the case of donated Microsoft software, schools will inevitably acquire additional or updated Microsoft applications. Even if this software is not best suited for the curriculum, cost pressures and technology "lock-in" will lead many schools down this self-perpetuating path. In so doing, a portion of local resources that may otherwise have been dedicated to preferred instructional software will instead be redirected to take advantage of the donations, leaving more pressing needs unmet.

³ Glenn M. Kleinman, Ph.D., "An Analysis of the Microsoft-MDSL Proposed Settlement", November 4, 2001, p. 6.

⁴ Magic School Bus series, My Personal Tutor series, and Creative Writer.

Moreover, some of the titles for instructional use included in the settlement work only on a Microsoft-compatible platform and not on competing platforms such as the Apple Macintosh. Similarly, the donated software includes Microsoft OS versions, while the provision for refurbished computers includes pre-installed versions of Microsoft Windows. With Windows-compatible PCs constituting some 90 percent of the desktop computer market, the supply of donations would inevitably follow a similar ratio, further skewing the marketplace in Microsoft's favor. This compares with Apple's share of the education segment at 47 percent (compared to 4 percent in the overall personal computer market).⁵ Thus, school districts' use of such newly donated resources would depend on their wholesale replacement of existing computer equipment with the transition costs being borne by schools districts. Experts confirm the experience of our industry that:

Each time a schools makes a commitment to a particular technological resource, many things must follow: teachers must be trained, lesson plans revised, software installed and technical problems resolved, technical support staff brought up to speed, students introduced to the software, assessments developed, and so on.⁶

Those districts unwilling to make such a transition would be placed at significant disadvantage in receiving Foundation awards. The proposed settlement does far too little in terms of both choice and addressing these direct costs to schools relative to these additional costs it may bring.

The settlement also emphasizes the availability and partial-reimbursement for refurbished computers. While a well-matched refurbished computer can, on a case-by-case basis, meet specific needs, managing refurbished computers has too often proven difficult in terms of network compatibility, memory availability for running programs and costs of upgrades. “[T]he

⁵ Education Commission of the States, “Investing in K-12 Technology Equipment: Strategies for State Policymakers, (originally published January 2001, updated August 2001).

⁶ Kleiman, p. 11.

net value of a corporate equipment donation [to schools] may in some cases actually be negative.” Panel on Education Technology, President's Committee of Advisors on Science and Technology, REPORT TO THE PRESIDENT ON THE USE OF TECHNOLOGY TO STRENGTHEN K-12 EDUCATION IN THE UNITED STATES at 23 (Mar. 1997). Yet, with school leaders facing enormous pressures to reduce their student-to-computer ratios, these long-term costs are too often outflanked by the short-term gains. In the end, schools are too often left with computers that fail to meet their needs and require significant investment to upgrade, integrate and maintain, while the community perceives the need met by donations and reduces its local investment.

As a result, the proposal's potential benefits are largely offset by its accompanying, inappropriate and detrimental “lock in” of Microsoft technology into the classroom and accompanying costs, including the resulting negative impact on competitors and the choices of education consumers. The result would be to further exacerbate Microsoft’s market dominance. The court should reject the argument that anticompetitive elements of the settlement are inevitable cost of assisting the disadvantaged. This approach does not meet the needs of students to have access to a diverse set of available software and hardware to meet specific needs. And it will squeeze out other viable and well-designed tools that teachers can use to meet their specific classroom needs.

There are a variety of alternative approaches and adjustments that could be adopted to support education technology, funded by Microsoft, and that would not produce the adverse educational and competitive effects identified above. For instance, if Microsoft’s donation were financial only and a completely independent and unbiased charitable foundation were entrusted to meet the settlement's sound goals, school districts and teachers could choose for themselves

which technologies — including which software applications and hardware platforms — best met the education needs of their students. Any such arrangement must avoid any pretense of being a marketing program under the guise of charitable works. Moreover, the funds used to accomplish these objectives must be administered independent of Microsoft control or influence.

These and a variety of other alternatives have been suggested to the court by parties commenting on the proposed settlement. We urge the Court to give them its most careful scrutiny in lieu of accepting a settlement which in fact undercuts the educational objectives that Microsoft and counsel for class plaintiffs offer as the rationale for their proposal.

CONCLUSION

For all these reasons, SIIA urges the Court to reject the proposed settlement in its current form in favor of a settlement that provides meaningful benefit to the class and to the educational needs of America's schoolchildren.

Respectfully submitted,

Of Counsel:

Glenn B. Manishin
Stephanie A. Joyce
Kelley, Drye & Warren LLP
1200 19th Street, N.W., Suite 500
(202) 955-9890
(202) 955-9792 fax

By: _____
Ken Wasch, President
Software & Information Industry
Association
1090 Vermont Avenue, N.W., 6th Floor
Washington, DC 20005
(202) 789-4440
(202) 289-7097 fax

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