

1 IN THE IOWA DISTRICT COURT FOR POLK COUNTY

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3 JOE COMES; RILEY PAINT,)
an Iowa Corporation;)
4 SKEFFINGTON'S FORMAL)
WEAR OF IOWA, INC., an) NO. CL82311
5 Iowa Corporation;)
PATRICIA ANNE LARSEN;)
6 and MIDWEST COMPUTER)
REGISTER CORP., an)
7 Iowa Corporation,)

) TRANSCRIPT OF
8 Plaintiffs,) PROCEEDINGS
)

9 vs.)
)

10 MICROSOFT CORPORATION,)
)

11 Defendant.)

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13 The above-entitled matter came on for
14 hearing before the Honorable Scott D. Rosenberg,
15 commencing at 9 a.m., October 11, 2006, in
16 Room 404 of the Polk County Courthouse, Des Moines,
17 Iowa.

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1 PROCEEDINGS

2 (The following record commenced at 9 a.m.

3 on October 11, 2006.)

4 THE COURT: All right. Mr. Hagstrom is

5 here. Ms. Kniffen.

6 MS. KNIFFEN: Kniffen.

7 THE COURT: Ms. Kniffen. Mr. Williams?

8 MR. WILLIAMS: That's right, Your Honor.

9 Good morning.

10 THE COURT: Mr. Jacobs. Mr. Green. Are

11 you Mr. Nelson or Casper?

12 MR. CASPER: I'm Charles Casper, Your

13 Honor.

14 THE COURT: Casper. So we have all the

15 parties here. Did you get that down?

16 We're here on the issue now of the

17 decertification of the classes.

18 Are the defendants ready to proceed?

19 MR. CASPER: Yes, Your Honor.

20 THE COURT: Please proceed.

21 MR. CASPER: Your Honor, Charles Casper for

22 Microsoft. I'm sitting here at counsel table feeling

23 very outgunned, but we will try to carry on

24 nonetheless.

25 Your Honor, it's been more than three years

1 since the class was certified in this case and much
2 has happened in that three-year period. In fact, the
3 world of this case has changed remarkably during that
4 three-year period. Let me be specific.

5 When the class was certified by Judge Reis
6 three years ago, it was a class which focused on much
7 narrower issues and products than it does now. It
8 was certified as a class involving operating systems
9 and applications, Word and Excel, which are usually
10 sold together in the program called "Office."

11 And so you had applications: Office, Word
12 and Excel -- and operating systems, and that was
13 really all that was in the case at that point.

14 The conduct that was alleged had largely
15 occurred before 1999. Well, the case has now
16 mushroomed into something much, much larger than it
17 was at that time. And the reason for that is largely
18 because the plaintiffs chose to file a fourth amended
19 complaint -- or fourth amended petition in this
20 court in early 2006. That petition changed things
21 remarkably. It added new markets. It added new
22 claims. It added a longer time period. In other
23 words, it changed the world of this case to one that
24 has never before been litigated in any of the class
25 actions that have been prosecuted against Microsoft

1 around the country in various states like this or in
2 the MDL case, the procedure in Baltimore. Let me be
3 specific about that.

4 First of all, the plaintiffs chose to add
5 new markets and new products. As I said originally,
6 the class was much narrower: operating systems, word
7 processing and spreadsheet.

8 Now, in the fourth amended petition, the
9 plaintiffs added allegations of anticompetitive
10 conduct into purported markets for products that the
11 named plaintiffs and most class members have never
12 even heard of.

13 For example, workgroup server operating
14 systems. Those are big operating systems that would
15 run industrial-strength servers, you know, back in
16 the back office. Those were never part of the case
17 before. Now they are. Dynamic Web Services, again,
18 things that happen in the back office, and embedded
19 devices. Those are devices like you might use in an
20 automobile or appliance or something like that where
21 an operating system is built into a piece of hardware
22 that a manufacturer would use in making a product.

23 Those are all things that were added by
24 paragraphs 206, 217 through 219 of the fourth amended
25 petition in this case.

1 The plaintiffs also allege for the first
2 time that there are technical ties and dependencies
3 between office and between networking and server
4 programs in paragraph 249 of the fourth amended
5 petition. Again, expanding new markets and new
6 products far beyond what was in the case at the time
7 that Judge Reis certified it back in 2003.

8 Secondly, longer time period. As I
9 mentioned, the third amended petition, which was
10 before the court when the class certification was
11 granted, alleged conduct that occurred almost
12 exclusively before 1999. But now the plaintiffs, by
13 adding all of these new markets and products, have
14 included conduct that goes almost up to today, adding
15 five or six years to the time frame. So we now have
16 a time frame in this case from 1994 to 2006, about 11
17 or 12 years, a very long time.

18 Now, back when the plaintiffs were
19 contemplating filing their fourth amended petition,
20 Judge Reis warned them that changing the time frame
21 might jeopardize their class certification. In an
22 order she entered that was on a discovery matter back
23 on December 17th of 2004, Judge Reis cautioned the
24 class counsel and she said, "The class has been
25 certified based on the allegations in the third

1 amended petition. An expansion of the case into new
2 markets or new conduct that could only have affected
3 more recent purchasers of the product may present
4 issues as to whether the class remains properly
5 certified and defined."

6 Well, the warning that Judge Reis gave at
7 that point has most definitely come true on account
8 of the new claims and markets that the plaintiffs
9 chose to add.

10 Also, Your Honor, the plaintiffs chose to
11 add new damages claims. Up to now and in all of the
12 other cases against Microsoft that have been brought
13 around the country, the plaintiffs sought one thing.
14 They sought what are called "overcharge damages."
15 They claim that the class members paid too much for
16 these products.

17 However, the plaintiffs here chose in the
18 fourth amended petition to add damages claims for
19 something else besides the price was allegedly too
20 high. They decided to add three new kinds of damage
21 claims, and these show up in paragraph 5 in the
22 prayer for relief of the fourth amended petition.

23 Now, the new claims that they now seek
24 damages for are a lack of choice, denial of the
25 benefits of innovation, and exposure to security

1 vulnerabilities. These, of course, are not
2 price-type antitrust claims. These are very
3 different types of claims. I will explain those more
4 as we go through the presentation, Your Honor.

5 The point to be made here, it has expanded
6 the class far beyond what was certified. And in
7 addition to that, these claims were never before the
8 court when the court certified it. They weren't
9 before Judge Reis when she certified the class. They
10 weren't before the Supreme Court when the Supreme
11 Court affirmed certification.

12 Really, the plaintiffs ought to be bringing
13 their own motion for certification. It shouldn't
14 really be Microsoft's job to be asking the court to
15 decertify these claims. The plaintiffs have the
16 burden to establish that these claims can be
17 prosecuted on a classwide basis and should by all
18 rights have brought their own motion, which they
19 didn't.

20 The next major change, Your Honor, is in
21 the volume licenses. The court may be aware that
22 there's a big difference between somebody who
23 purchases a product individually like the named
24 plaintiffs did, all of the named plaintiffs, and
25 companies and universities and large organizations

1 that buy them in massive volume units. As I will
2 explain, the way that business is conducted is very
3 much different than walking into a store and picking
4 up a copy of Microsoft Office.

5 Early in the class period, in 1994, only
6 about a third of the applications which are where
7 most of the volume licenses occur, only about a third
8 of the applications were volume licenses. But by
9 2005 that number had mushroomed to 60 percent so that
10 here in Iowa about 60 percent of the licenses for
11 applications -- that means for Office and Word and
12 Excel -- that the plaintiffs seek to represent in
13 this court are volume licenses owned by companies and
14 organizations that bought them in bulk. None of the
15 named plaintiffs participated in that kind of
16 purchase and therefore ought not to be able to
17 represent those large-volume plaintiffs here.

18 And, finally, Your Honor, on the issue of
19 pass-through, the plaintiffs got class certification
20 in this case based upon their theories and based upon
21 their predictions of what they would be able to show.
22 For example, their expert on this issue at the time,
23 Professor MacKie-Mason of the University of Michigan,
24 said that he believed that plaintiffs would be able
25 to prove with common evidence that all class members

1 were injured.

2 And he said that they should be able to do
3 that because the resellers who buy from Microsoft
4 must pass-through any cost increases including cost
5 increases attributable to the overcharge the
6 plaintiffs allege. He said they "must" do that.

7 Well, at the time there was no evidence one way or
8 another of what they actually did, but now there is.

9 The resellers themselves here in Iowa have
10 testified that they don't always pass-through cost
11 increases and decreases, that for a wide variety of
12 competitive reasons they choose to absorb them
13 instead. And the data that have been produced by
14 resellers, both here in Iowa and also elsewhere in
15 the other cases that were pending around the country,
16 have been analyzed by the econometricians, and the
17 data clearly show that the resellers don't all act
18 alike.

19 So plaintiffs' theories have now been
20 tested by facts, and the facts show that there was
21 not the commonality that the plaintiffs said there
22 was going to be.

23 Your Honor, I'm going to focus my remarks
24 this morning on three areas of change that I've
25 discussed. The first is the volume licenses and the

1 changes that have been made there.

2 The second are these new damage claims for
3 loss of innovation and security vulnerabilities and
4 lack of choice. That's the second.

5 And third is the pass-through issue on
6 which we now have evidence.

7 With respect to the volume licenses, Your
8 Honor, we will show, as I said before, that the world
9 has changed very much. Before I start down that road
10 though, I probably ought to pause for a moment to
11 respond to what the plaintiffs said was the standard
12 for decertification.

13 Now, the plaintiffs in their papers tried
14 to make it appear that the standard for
15 decertification was some very high standard that, you
16 know, we would have to move heaven and earth to meet.

17 Nothing could be farther from the truth.
18 Fortunately, the Iowa Supreme Court has had an
19 opportunity to rule on this question twice. The
20 first time the court ruled on it was only three years
21 ago in Vos v. Farm Bureau Life Insurance Company.
22 That's reported at 667 N.W.2d at 36, a 2003 case.
23 And that's a case in which the court affirmed class
24 decertification when the promise that the plaintiffs
25 made that there would be common evidence turned out

1 not to be true when the discovery was ended and the
2 case was ready to go to trial.

3 Just like here where the plaintiffs said
4 there will be common evidence, we will be able to
5 prove our case by common evidence, and it turns out
6 that, in fact, the evidence required would be
7 individual in order to prove it. Decertification is
8 in order. The Iowa Supreme Court affirmed the
9 decertification there.

10 Secondly, the Supreme Court in our own case
11 and this case of Comes v. Microsoft citing the Vos
12 case, said that the decertification of the class was
13 a safety net that this court could invoke if
14 necessary. As the court said, our Supreme Court
15 said, "The court may decertify the class at a later
16 time." As they also said, "The court may decertify
17 the class if circumstances so require."

18 And, of course, that makes sense as the
19 Iowa Supreme Court said in the Comes opinion because
20 the Iowa rules require class certification to be
21 preceded with as soon as practical, and so it happens
22 before the evidence is in, before a lot of facts are
23 known. And, frankly, you have to take, in view of
24 the Supreme Court, a lot of things on faith according
25 to what the plaintiffs say they are going to do.

1 And the court noted that if it turns out
2 not to be true, of course, then you can decertify the
3 class. It makes perfect sense as the court admitted.

4 THE COURT: Now, there are alternatives,
5 but not total decertification, but just limited to
6 what they were originally certified for?

7 MR. CASPER: That is a possible
8 alternative, Your Honor, although here we would say
9 that so much has changed that total decertification
10 is in order.

11 The other place in which we pointed out
12 that the court does have that alternative is on the
13 volume licensing claims and also these new claims for
14 security breaches and so forth.

15 It's clear now that the volume licensing
16 claims should not be in the class, and so we've asked
17 that even if the case was not decertified in total,
18 the volume licensing claims ought to be taken out for
19 want of a volume-class plaintiff.

20 And, secondly, the security claims as
21 explained are inherently individualistic. There's
22 just no way that you could establish claims for, you
23 know, viruses infecting a computer on a classwide
24 basis. It's just impossible, as we will see. So,
25 yes, that is an option that the court has.

1 And, in fact, Rule 1.265(1) says that, "The
2 court may amend the certification order at any time
3 before entry of judgment to do" -- among other
4 things -- "eliminate from the class any member who
5 was included in the class as certified."

6 So the Court has great authority here and
7 the plaintiffs' assertion that there is some sort of
8 heavy burden or a law of the case that would prevent
9 the court from doing what it thinks is best here is
10 just plain false. Vos didn't say that. The Supreme
11 Court in Comes didn't say that.

12 And, in fact, if you look at the
13 authorities on law in the cases in Iowa, you find
14 that it's inapplicable when different facts are
15 presented on remand. That's United Fire & Casualty
16 v. Iowa District Court, an Iowa Supreme Court
17 decision from 2000. So it's just plain that the
18 court is not constrained in the way that the
19 plaintiffs claim the court is constrained.

20 It's the same in the federal system too,
21 Your Honor. The Eighth Circuit has also ruled in a
22 case called Blades v. Monsanto, which is reported at
23 400 F.3d at page 567, a 2005 decision, very recent
24 decision from the Eighth Circuit. The Eighth Circuit
25 said, "A decision to certify or not certify a class

1 may require revisiting upon the completion of full
2 discovery."

3 That's where we are, Your Honor. We are
4 now at the time for that, and this court has wide
5 discretion and is not constrained in the way the
6 plaintiffs improperly argued.

7 Let me jump in then, Your Honor, if I may,
8 to the first of the three topics I would like to
9 present this morning, and that is volume licensing.
10 We believe that the volume licensing and the other
11 problems are so severe that the court ought to
12 decertify the entire class. But, of course, an
13 option the court has is simply to exclude the volume
14 claims, if the court were to decide to proceed that
15 way.

16 Your Honor, the problem with the
17 plaintiffs' volume licensing claims here is that it
18 violates one of the fundamental premises of a class
19 action. One of the fundamental premises is that
20 proving the named plaintiffs' claims will prove all
21 of the claims of the class members, the whole class.
22 And, of course, that makes sense because that is why
23 you don't need to bring in all the hundreds of
24 thousands of people in Iowa who bought these products
25 if by proving the claims of the four named

1 plaintiffs, it proves everybody's claims.

2 As the Sixth Circuit put it back in 1998,
3 "As goes the claim of the named plaintiff, so go the
4 claims of the class." Well, that has to be the case
5 here. But, in fact, it's not the case here because
6 of the big difference between volume purchasers and
7 individual purchasers.

8 So let me give you an example, Your Honor.
9 Patricia Larsen, who is one of the named plaintiffs
10 here, bought a copy of a Windows 98 upgrade from
11 Sam's Club. She walked into Sam's Club. Presumably,
12 she picked it up off the shelf, and she paid
13 whatever price was put on the box.

14 Now, the question before the court is if
15 she succeeds in proving that she paid Sam's Club too
16 much for that copy of Windows 98 in a box, is that
17 going to prove that Maytag or the Principal Group or
18 Pioneer Hi-Bred or Wells Fargo Mortgage or any of the
19 other of hundreds of companies here in Iowa that
20 licensed on a volume basis, is that going to prove
21 that they were overcharged too? Of course it
22 wouldn't. And the reason it won't is because the
23 entire way of doing business is different between
24 these channels, the volume channel, and of the other
25 channels.

1 To give you an example, Your Honor, I will
2 cite to the volume-licensing programs that exist.
3 There are three volume-licensing programs, and two of
4 them work very much the same way and the third is not
5 too much different.

6 The largest is called an "Enterprise
7 Program." And "Enterprise" is a word that the
8 techies use for big companies or for businesses.

9 The Enterprise Program requires 500 PCs or
10 more in your organization. It has a three-year term
11 of agreement, and you don't just get a piece of
12 software like Mrs. Larsen got when she went into
13 Sam's Club. What you get, if you have an Enterprise
14 Agreement, is you get a three-year term, and you get,
15 whatever new versions, whatever upgrades, whatever
16 service packs, whatever maintenance releases are
17 released during that period. So you're not buying
18 just one thing, you're buying a whole bunch of
19 things; and you don't even know what they are because
20 you're buying a promise to give you things as they
21 are released in the future.

22 Now, the class members have to buy these
23 things individually. When Windows 98 was replaced by
24 window ME, if Mrs. Larsen wanted it, she had to go
25 buy it from Sam's Club again or another reseller.

1 Somebody who has an Enterprise Agreement
2 doesn't have to do that. They get whatever upgrades
3 come within the term. They also get much, much lower
4 prices. Obviously, these large companies and
5 organizations have bargaining power. They don't just
6 walk into Sam's Club and pay whatever price is on the
7 shelf. They have the ability to bargain with their
8 resellers over these terms of the contract, and, in
9 fact, the contracts aren't just a sale like at a cash
10 register; they are actually individual agreements.

11 Each one of these volume customers has what
12 is called a "volume licensing agreement" with a
13 reseller and with Microsoft in which these
14 transactions were all worked out.

15 Now, in addition to getting low prices,
16 they also don't just buy software. They typically
17 buy bundles of products and services from these
18 resellers. The resellers who sell these volume
19 licenses are specialized resellers called "large
20 account resellers," and they are specialized
21 companies. There's only about 18 of them in the
22 whole country, and they sell to everybody in the
23 country, including people here in Iowa.

24 And we now have in the record declarations
25 from four of these 18 large account resellers that

1 explain how the business works and why it is that
2 buying from them is very much different than just
3 walking into Sam's Club and picking up a copy of
4 Windows 98 off the shelves. Not only do you get
5 lower prices, but you also get these bundles of
6 hardware and software and so forth that are
7 individually negotiated.

8 The declarations that establish the facts
9 that go into this are the declarations of James Grass
10 and Larry Malashock and David Stubbs and William
11 Morris, and those gentlemen worked for four different
12 volume resellers. One is called "CDW Computer
13 Centers" which is up in Illinois. One is called
14 "Software Plus," which is in St. Louis. One is
15 Hewlett-Packard, which is in California, of course;
16 and the other is Dell, which is in Texas.

17 And, Your Honor, those declarations are
18 short, and I think they might be helpful to the
19 court. They are found in Appendix W at Exhibits BB
20 through EE. So it's BB, CC, DD and EE of the
21 appendix to our original brief, and the court can
22 read those.

23 Here is what those gentlemen said about how
24 the Enterprise Program and also the Select Program,
25 which is similar to that, only with the Select

1 Program you can go down to as low as 250 now. You
2 don't need 500 PCs. You can have as few as 250 and
3 still be in the Select Program.

4 So here is what they said about how these
5 programs work, and these are the facts that are now
6 in the record that weren't there at the time the
7 court certified the class back in 2003:

8 First of all, bargain power. All of these
9 gentlemen pointed out that the bargain power they
10 have leads to individually negotiated deals; not just
11 for software, but also for software, hardware and
12 services which these resellers sell. They are not
13 just software resellers. They are what you might
14 call "total solutions" resellers, and typically these
15 companies don't just go to them and say, "I would
16 like 500 copies of Windows or 500 copies of Office."
17 They say, you know, "I want you to help me build my
18 Total Solutions. I want you to help me with
19 everything I need: my hardware, my software, my
20 services. I want you to help me keep track of it."
21 That's the kind of business that these folks are in,
22 these large account resellers.

23 Mr. Stubbs, for example, from HP said that
24 individually negotiated deals are common, and
25 typically they were for the so-called "Total

1 Solutions": hardware, software and services;
2 including maintenance, technical support, things of
3 that sort.

4 Mr. Grass of CDW, one of the other ones,
5 said that volume companies typically shop from one
6 reseller to the next. They are not tied to one.
7 They can compare these resellers to each other and
8 get the best deal they can.

9 And Mr. Grass said that in order to close a
10 sale, he typically has to sell Microsoft software and
11 a bunch of other products and services at the very
12 best price he can or he has to educate the consumer
13 as to how they are going to do better in the long run
14 with his company by buying from his company instead
15 of buying from somebody else.

16 So you've got the bargaining power that
17 individual plaintiffs like the named plaintiffs
18 here -- just don't have leads to lower prices. The
19 lower prices come in two different ways. One is, of
20 course, the resellers themselves compete with each
21 other to give the best price.

22 The second one is that some companies are
23 large enough that they can actually go to Microsoft
24 and say, "Look, I want to buy a lot of copies of
25 Windows or Office, and I'm going to buy it from one

1 of the resellers because I can't buy directly from
2 you. You don't sell directly to me in the kind of
3 program I want, so I'm going to buy it from the
4 reseller. But here is what I want you to do,
5 Microsoft. Because I'm so big, I want you to give
6 the reseller who is going to buy from me a special
7 deal so they can give me an even lower price than
8 they otherwise would."

9 And as these gentlemen testified and also
10 Christopher Kinney, who is the Microsoft person who
11 works in this area, also testified, Microsoft will
12 for these large companies, if asked and if the
13 negotiation works out, they will provide a so-called
14 "lower reference" price that will then be available
15 to any one of the resellers. And so the customer can
16 then go to a reseller and say, "Look, I got a special
17 deal from Microsoft. Now what can you do for me?"
18 And this gets played out in the marketplace.

19 Again, totally different from what happens
20 when Mrs. Larsen walks in Sam's Club. In fact,
21 because of the negotiations that go on, each sale
22 really is unique. And it's unique not just for
23 software, but for the bundle that goes on.

24 Now, a lot of the resellers make their
25 money on different things depending on what their

1 motto is. Some of them regard things like software
2 and sometimes even hardware as low-profit items that
3 they don't care that much about, and so they'll make
4 their money on services or other things. How the
5 individual reseller does it is really up to that
6 reseller.

7 The point, however, is that when you have
8 these bundled transactions, you can't know whether or
9 not the price of Windows or Office or whatever is
10 being licensed in that fashion is at price X or Y or
11 Z because it's very often mixed up with this bundles;
12 and the reseller can be selling Office or Windows at
13 a really low price, but they are making all their
14 money on something else. So there's no way to tell
15 that.

16 And, in fact, Professor Catherine Morrison
17 Paul, who is an economist at the University of
18 California, who we asked to look at this, looked at
19 the data that is available to see if you could even
20 tell based on the data that has been produced in this
21 case how much the companies paid for their volume
22 licenses. And she found that you can't, and the
23 reason is these volume resellers don't report to
24 Microsoft how much they are charging, and, you know,
25 we have no right to know that.

1 So the only way to find out how much they
2 are even paying would be to go to the resellers or go
3 to volume customers themselves which would require
4 individual inquiries in and of themselves.

5 So those kinds of transactions for doing
6 business are just completely different than what goes
7 on because of the bargaining power, the negotiations
8 and also the bundles.

9 There's a third program, which I didn't
10 describe yet. The first is the Enterprise Program,
11 which is 500 computers, three-year term. The second
12 one is the Select Program, which used to be 500, now
13 it's 250 computers. Used to be two-year term. Now,
14 I believe, it's a three-year term.

15 The third is called an "Open Program," and
16 an Open Program can be as few as five licenses and as
17 many as 249. And with the Open Program, you don't
18 get that through one of these specialized volume
19 resellers. You can get that through a more normal
20 reseller, but you still have the same basic
21 characteristics because you've got somebody buying in
22 bulk. Once again, even if it's smaller, obviously,
23 than the others, you still have people buying in bulk
24 who are able to negotiate.

25 And, indeed, two of the resellers who

1 provided affidavits in this case -- the Iowa
2 resellers, who are sort of regular resellers as
3 opposed to these big, large resellers said that, in
4 fact, they negotiate and sometimes give better prices
5 and better deals on bundles and other things to folks
6 who buy volume licenses from them through this Open
7 Program.

8 Now, we now have the data on how many
9 volume licenses there are in Iowa, which we didn't
10 have before.

11 As I mentioned earlier, the total has gone
12 up dramatically, but we have data. As I said, by the
13 year 2006, 60 percent of the applications -- that
14 means Office, Word and Excel -- licenses in Iowa are
15 volume licenses. So when Mrs. Larsen and the others
16 get on the stand and try to convince the jury that
17 they paid too much for their copy of whatever it was,
18 they are only going to be standing in for 40 percent
19 of the minority of the copies that are at issue in
20 this case. Sixty percent of those copies are going
21 to be bought through this entirely different system
22 that Mrs. Larsen wouldn't know the first thing about.

23 In terms of the numbers, the numbers of
24 volume licenses amount to more than two million here
25 in Iowa in this class. More than two million of the

1 licenses at stake are volume licenses. So this is
2 not some trivial, insignificant small point. This
3 has now grown over the years to be a very major part
4 of the case, and that is why we're now before the
5 court here today. Now we have these numbers and the
6 significance has grown.

7 It's large. It's too large to ignore, and
8 the system is just too different from the named
9 plaintiffs' way of purchasing to be appropriate for
10 classwide treatment.

11 Now, Your Honor, two courts have ruled on
12 this issue, and only two have ruled on this issue
13 before. It came up in the MDL proceedings. You
14 remember that the federal proceedings were all
15 consolidated before Judge Motz and the U.S. District
16 Court for the District of Delaware, and this issue
17 came before him and then it was appealed. His ruling
18 was appealed to the Fourth Circuit, and the Fourth
19 Circuit ruled just this year on this issue.

20 And those courts both did exactly what
21 we're asking this court to do.

22 In that case the only volume licenses at
23 issue were the Enterprise licenses, which, as I said,
24 were very much like the Select licenses. And just
25 for the reason of that case because that was a

1 direct-purchaser case that only the Enterprise
2 licenses were before the court, the court held that
3 the named plaintiffs, who, like here, were not volume
4 licensees, could not prosecute the claims of these
5 large-volume Enterprise customers.

6 And the reasons that both Judge Motz and
7 the Fourth Circuit cases were the very same ones we
8 presented here are because these are three-year
9 terms, because they are bundles, because they are
10 negotiations, individual negotiations, which led to
11 discounts and different bundles. Therefore, those
12 individual plaintiffs simply couldn't stand for these
13 Enterprise customers.

14 Now, the opinion that is the best one, I
15 think, to see this most concisely is to look at the
16 Fourth Circuit case, which is a case called Deiter v.
17 Microsoft. It's reported at 436 F.3d at page 468.
18 And the Fourth Circuit said in that opinion -- and
19 doing exactly what we're asking the court to do here,
20 the Court said, "Plaintiffs' proof that Microsoft
21 overcharged them would hardly prove that Microsoft
22 overcharged the Enterprise customers."

23 As the court went on to point out,
24 "Enterprise customers would need new and different
25 proof because the Enterprise customers were able to

1 negotiate their deals in a different competitive
2 context from that involving the plaintiffs."

3 And the court then went on to point out
4 that these factual dissimilarities involving bundles,
5 negotiations, et cetera, simply made the named
6 plaintiffs too different from the Enterprise
7 customers and, therefore, the court did exactly what
8 we're asking the court here to do.

9 Now, there is some difference in the
10 federal and the Iowa rule because Iowa is one of two
11 states to adopt this so-called "uniform rule." This
12 is one where the commissioners on uniform state laws
13 didn't do quite as good a job of selling their
14 uniform rules. They only convinced two states, but
15 Iowa is one of them.

16 Iowa adopted the rule in 1980. Of course,
17 this court has been dealing with it ever since, as
18 those of us who litigate here. But the concepts in
19 the rules are really very much the same even though
20 the terminology is quite different.

21 In the federal system you have
22 typicalities; that is, the named plaintiff has to be
23 typical of the claims of the class. You have
24 commonality. The claims have to be common claims.
25 And then you have adequacy of representation.

1 And those all go together to mean that the
2 claims that are being articulated by the named
3 plaintiff have to be similar enough to the other
4 claims of the class members that it's fair to let
5 that person stand in and prosecute the claims of all
6 the class members.

7 Now, the plaintiffs have said in their
8 papers that because the Iowa rule when it was amended
9 in 1980 doesn't use the word "typicality" anymore,
10 that Your Honor should just ignore everything we're
11 saying about volume licenses and that you shouldn't
12 even consider whether to exclude them because the
13 Iowa rule doesn't mention typicality.

14 Well, that simply ignores what the Iowa
15 rule does include, and it also ignores decisions of
16 Iowa Supreme Court that reaffirm that the concept of
17 typicality is still very much part of Iowa juris
18 prudence, even though the word isn't used in the
19 rule. And here is why that is true, Your Honor.

20 The Iowa rule does require, specifically,
21 that the plaintiffs show that a class action has to
22 be permitted for the fair and efficient adjudication
23 of the controversy. That's really the ground, the
24 bedrock of what we're doing here.

25 The Iowa rule also requires that the

1 representative parties fairly and adequately will
2 protect the interest of the class. And then as a
3 factor -- one of the many factors for deciding
4 whether the class action will, in fact, be the most
5 fair and efficient adjudication of controversy
6 includes whether common questions predominate.

7 So you have these questions of commonality
8 and predominance, adequate representations and fair
9 and efficient adjudication. Those are the Iowa
10 rules. That's the framework we operate under here.

11 Well, the U.S. Supreme Court in a case
12 called *Amchem* at 521 U.S. at page 626 back in 1997
13 said that the requirements of adequacy and of
14 commonality and of typicality tend to merge. That's
15 what the U.S. Supreme Court said, and it said that
16 those requirements merge and become guideposts for
17 determining whether the named plaintiffs' claims and
18 the class claims are so interrelated that the
19 interest of the class members will be fairly and
20 adequately protected in their absence.

21 So the reason that it doesn't matter that
22 the word "typicality" isn't in the Iowa rule anymore
23 is, as the Supreme Court articulated, because
24 typicality, commonality and adequacy, which are in
25 the Iowa rule, tend to merge in order to do this.

1 Now, this isn't just me talking, Your
2 Honor. The Iowa Supreme Court has recognized the
3 same thing. In 1990, about ten years after the Iowa
4 rules changed, the Supreme Court decided Hammer v.
5 Branstad. And in that case -- it was a case of
6 whether the claims of the named plaintiff were close
7 enough, whether the named plaintiff had been injured
8 in the same way as other class members. That was the
9 issue before the court there, and the Iowa Supreme
10 Court said, quoting a treatise that the plaintiffs
11 rely on -- a treatise, actually, by a fellow from
12 Philadelphia named "Newberg" -- quoted the treatise
13 and said, "The claims of the plaintiff must be
14 typical of the claims of the class."

15 THE COURT: Would you cite the volume and
16 page number again?

17 MR. CASPER: Yes. That's 463 N.W.2d at
18 page 89, 463 at page 89.

19 THE COURT: Is that the jump cite?

20 MR. CASPER: Yes, at page 89.

21 THE COURT: Give me the first one.

22 MR. CASPER: The first page on Hammer v.
23 Branstad is 86.

24 THE COURT: Thanks.

25 MR. CASPER: And Hammer v. Branstad took

1 that concept, that there can be requirements in the
2 Iowa rules that aren't specifically set out, from an
3 earlier case called Vignaroli v. Blue Cross. And
4 Vignaroli was a 1985 case, and that's at 360 N.W.2d
5 and it begins at 741; 360 N.W.2d beginning at 741.
6 And the page that I'm referring to is 743 when the
7 court said that here's the new rules that the courts
8 still rely "heavily on federal authorities concerning
9 similar provisions of the federal rules."

10 And, of course, the Hammer v. Branstad
11 court picked up on that and used the "typicality"
12 language which comes from the federal rule but is
13 very much present in Iowa law in addition to that.

14 THE COURT: In your review of authorities
15 since Hammer, has that changed in the Iowa Supreme
16 Court?

17 MR. CASPER: No, there hasn't been any
18 change in that from the Iowa Supreme Court, and, in
19 fact, the most recent case that I'm aware of, Your
20 Honor, is a case by one of your colleagues here on
21 the Polk County Bench, and that's a case called
22 Merrifield v. Ameriquest Mortgage, and it's published
23 electronically on Westlaw and the citation for that
24 is 2003 Westlaw -- I've got to give the court a very
25 long number -- 22462948.

1 THE COURT: Is that a Court of Appeals
2 decision?

3 MR. CASPER: No. That's a trial court
4 decision by one of your colleagues right here, but
5 it's the only decision that we were able to find
6 since Hammer v. Branstad to take this issue up. And
7 there at *6, which is the way you cite pages on these
8 Westlaw cases, the Court said, quoting Hammer v.
9 Branstad, "The claims of the plaintiff must be
10 typical of the claims of the class." So I don't know
11 what better confirmation we can have that that
12 requirement is very much a part of Iowa law despite
13 what the plaintiffs say.

14 And perhaps -- well, Your Honor, I take it
15 back. There is one better piece of confirmation. If
16 you were to look at paragraph 23 of the fourth
17 amended petition, which the plaintiffs wrote, you
18 would find the following sentence: "The named
19 plaintiffs' claims are typical of the claims of
20 absent class members." Now, why would they have put
21 that in the fourth amended petition if it wasn't a
22 requirement of Iowa law?

23 As the Fourth Circuit found, Your Honor,
24 individual plaintiffs aren't typical of Enterprise-
25 volume customers. The same is true for Select

1 customers. The same is true for Open customers.

2 Those customers, Your Honor, should not be
3 in this class with four individuals and companies,
4 small companies -- two individuals and two small
5 businesses representing them. They simply shouldn't
6 be there.

7 This case has been around for six years.
8 If the plaintiffs had wanted to bring in a volume
9 customer as a named plaintiff, there's no shortage of
10 them. As we pointed out by attaching a table to
11 Professor Paul's affidavit, there are more than 50
12 companies in Iowa which have more than 1,000 licenses
13 and there are many, many, many more companies in Iowa
14 which have smaller numbers of volume licenses. If
15 those companies truly thought that they had been
16 overcharged, they could be here. They had six years
17 to join up. They haven't. The plaintiffs simply
18 shouldn't be allowed to go forward with what it is
19 now.

20 Now, the plaintiffs' resistance on this
21 point, Your Honor, has been very, very weak. First
22 of all, of course, they said, "Well, you should
23 simply ignore this because Iowa doesn't recognize
24 typicality."

25 Secondly, they say, "Well, gee, you settled

1 the case up in Minnesota, and the Minnesota case
2 included volume claims, so you explicitly conceded
3 that they ought to be here."

4 Well, two responses to that:

5 First of all, the settlement agreement in
6 Minnesota, which Mr. Hagstrom and Ms. Conlin signed,
7 specifically said, "No aspect of this settlement
8 shall have any bearing in any other litigation.
9 Nothing agreed should guide other courts 'in any
10 way."

11 That was one of the terms of the settlement
12 agreement, and that's natural because you do things
13 in settlements that are different than what you're
14 willing to agree to in a litigated case.

15 THE COURT: Well, in any event, a
16 settlement isn't precedential value for any court, is
17 it?

18 MR. CASPER: It certainly shouldn't be,
19 especially in a case with a provision like this.

20 And also this particular issue was never
21 raised in Minnesota. The only time this issue has
22 been raised was in the MDL proceeding, and it's been
23 resolved in the MDL proceeding. This issue has not
24 been raised by Microsoft or the plaintiffs anywhere
25 else, including Minnesota. So that is -- so their

1 first two resistances are: No typicality, "You
2 settled the case in Minnesota." That shouldn't make
3 any difference.

4 Then they say, "Well, Microsoft is really
5 overstating the difference between volume customers
6 and between others," and they point out that some
7 volume customers didn't buy very many licenses. And,
8 of course, that is true because you can buy as few as
9 five. And so they compare a volume customer who
10 bought just a few to the named plaintiffs who the two
11 companies apparently had either 20 or 30 licenses
12 over the entire period. And they say, "Well, there's
13 really not that much difference."

14 Well, of course, you can always compare the
15 smallest thing in one group to the largest thing in
16 another, and you can find that they are not that
17 dissimilar. But when you look at the overall
18 numbers, the dissimilarities are very great.

19 For example, the averages of the customers
20 who in Iowa who had Enterprise licenses which require
21 500 or more computers, the average number of licenses
22 is over 8,000. And there are many companies who have
23 tens of thousands.

24 If you look at the Select Program where you
25 only have to have 250, the average number of licenses

1 is 651. That is very, very different from the named
2 plaintiffs in the one, two, three, four and even
3 thirty, if you look at the small businesses.

4 The resistance did not include any evidence
5 from any reseller, volume reseller or any other
6 reseller, to contradict the evidence that Microsoft
7 has cited, or how the program works for the kind of
8 deals, bundles and so forth, that are available under
9 it, or for the bargaining power that these large
10 companies have.

11 All of this, Your Honor, I believe, makes a
12 convincing case that this class should not continue
13 to be certified for these volume customers. That at
14 the very least, the court should exclude the volume
15 customers from certified classes if it doesn't
16 decertify the class altogether.

17 Your Honor, I will move on now to the
18 second point which I wanted to make which is about
19 these new claims for loss of choice and innovation
20 and security and so forth.

21 Now, first of all, the plaintiffs
22 themselves have narrowed their claims somewhat by
23 giving up the ghost on one of them. They added three
24 claims that I want to point out to the court here.

25 One was a lack of product choice, the second was this

1 exposure to security vulnerabilities, and the third
2 was reduced innovation in computer software. They
3 say that those three things are all consequences of
4 Microsoft's allegedly anticompetitive conduct.

5 Now, the first one, which is lack of
6 product choice -- which, I guess, means if Microsoft
7 had been more competitive, they say, then customers
8 would have had more computer parts to choose from --
9 well, they gave up the ghost on that one, and their
10 resistance on page 58 at footnote 29 they admitted
11 that they were abandoning this claim. So that takes
12 us to the main one they press, which is the claim for
13 exposure to security vulnerabilities.

14 Now, security vulnerabilities is kind of a
15 fancy way for saying "viruses." That's what most of
16 us who are nontechnical -- we read in the paper. And
17 a few of us -- and I hope Your Honor hasn't had this
18 experience -- have actually experienced a virus on
19 their computer which might do something harmful to
20 it, or someone might take control of your computer,
21 or might do something harmful to it.

22 THE COURT: I don't have a computer yet.

23 MR. CASPER: Well, Your Honor, you may be
24 one of the most fortunate people in the courtroom --

25 THE COURT: I'm kidding.

1 MR. CASPER: -- if that were true. I think
2 about how we used to practice law before we had
3 telecopy machines. Now we live on e-mail. That's
4 why. I guess it's good.

5 In any event, the plaintiffs say that they
6 can proceed on a classwide basis on these claims
7 that Microsoft's allegedly anticompetitive conduct
8 led to more security vulnerabilities being available
9 and I presume more people being hurt by it.

10 So there are a couple of layers we have to
11 look at to understand what they are really saying
12 here.

13 First of all, of course, none of this was
14 before the court in 2003. You know, Judge Reis was
15 presented with no claim whatsoever for security
16 vulnerabilities. This has never been certified.
17 This claim has not been certified by any court
18 anywhere. This is really new in the first instance
19 here. The plaintiffs really should be bringing a
20 motion for class certification on this point.

21 The Iowa Competition Law, of course,
22 provides that a person who is injured may seek to
23 recover his or her "actual damages resulting from
24 conduct prohibited under the competition law."
25 That's Section 553.12 and .12(2) of the Iowa Code:

1 Actual damages.

2 Now, what that means is if the plaintiffs
3 are going to claim that people have been harmed
4 because their computer was attacked by a virus, they
5 have to be able to show that the person who is a
6 class member -- and there are hundreds of thousands
7 of them as the court knows -- suffered actual damages
8 as a result of that conduct.

9 Now, that, of course, is an inherently
10 individual question. I mean, you have to ask
11 questions such as, you know, "Did you encounter a
12 virus?" If you didn't, obviously you weren't hurt.
13 "If you did encounter a virus, did it do any harm?"
14 Again, if it didn't, then you weren't hurt. "If it
15 did do harm, how much did it do?" "Was it some
16 trivial, small piece of harm or did it wipe out your
17 entire hard disk?" You would have to ask that
18 question.

19 You would also have to ask, "Well,
20 Microsoft is being accused of making computers more
21 vulnerable to security. Well, did you do anything to
22 protect your computer?" If you did, then that might
23 have been efficacious and you wouldn't have been hurt
24 even if there was a vulnerability. "If you did do
25 something to protect your computer, what did you do?"

1 "Did it work?" "In doing this, did it cost you any
2 money or cost you any time?"

3 These are all inherently individual
4 questions which if any person in Iowa sued Microsoft
5 on this claim, we would have a right, a perfect
6 right, to cross-examine them on the basis of these
7 kinds of issues. In fact, the court wouldn't even
8 consider it a prima facie case, I don't think, unless
9 these individuals had testified that they were
10 actually hurt in some fashion.

11 Well, the plaintiffs, of course, realize
12 that this isn't a classwide type of claim. And so
13 they've come up with this way around the problem by
14 saying, "Well, here is what we're going to say, Your
15 Honor," they say. They say that Microsoft puts out
16 so-called "patches" when it identifies security
17 vulnerabilities in some of its products. And, of
18 course, that's true of every company that has
19 computer software. Security is such an issue now
20 that Microsoft and Apple and, you know, everybody
21 else who puts out software, issues patches.

22 The "patch" means a little piece of code
23 which changes the underlying program in some way.
24 Any time there's a security vulnerability detected,
25 Microsoft puts out these patches and users -- some

1 users install them. And if you do install them, of
2 course, it protects you against whatever that
3 particular problem is. Well, the plaintiffs say --

4 THE COURT: There's no cost for these
5 patches, is there?

6 MR. CASPER: No, they are free. They are
7 free over the Internet.

8 And the plaintiffs say, "Well, here is our
9 theory for why this is classwide. We're going to
10 assume that every person in Iowa installed every one
11 of these 113 patches they've identified, and we're
12 going to assume that it took these people a fixed
13 amount of time to do it. And we're going to assume
14 the person did nothing else.

15 They sat there and twiddled their thumbs
16 while this patch was downloading at a certain speed,
17 at the speed you would if you had a dial-up
18 connection over the telephone as opposed to a cable
19 modem or DSL modem or something like that. We're
20 going to assume they twiddled their thumbs while this
21 downloaded at telephone speed, and then we're going
22 to assume that their time is worth the average wage
23 in Iowa and that is all going to make this classwide.
24 Presto. We've now figured out how to make a class
25 action out of security vulnerabilities.

1 Well, of course, that doesn't hold water,
2 and it doesn't hold water for lots and lots of
3 reasons. The first one is that the very fact that
4 there are security vulnerabilities is not necessarily
5 due to Microsoft's anticompetitive conduct. That's
6 kind of a fundamental assertion, and the plaintiffs
7 haven't done anything to prove that these security
8 vulnerabilities are the result of anticompetitive
9 conduct.

10 They haven't shown how in the so-called
11 "but for" world in the absence of Microsoft's
12 anticompetitive conduct it would be any different.

13 And, of course, it's not likely because
14 every company has these issues. Microsoft, as I
15 said, has them. Apple has them. The companies that
16 produce other operating systems, you know, like Linux
17 and Unix, have them too. This is just an
18 industrywide phenomenon.

19 So the question of whether it would be any
20 different if there weren't any anticompetitive
21 conduct, which is an essential part of the
22 plaintiffs' claim, is something they haven't been
23 able to substantiate.

24 Now, they have an expert named Professor
25 Noll who teaches at Stanford. At his deposition we

1 asked Professor Noll about this, whether you would
2 have to speculate in order to cause it, what would
3 have happened, you know, but for the allegedly
4 anticompetitive conduct.

5 And here is what Professor Noll said. The
6 question was:

7 "And am I right in thinking to try to
8 posit what the technology would have been
9 in a more competitive hypothetical would
10 require an economist to indulge in
11 speculation?"

12 This is their expert being asked if he's
13 going to speculate.

14 Mr. Hagstrom said: "Object to form."

15 The witness said: "Usually, though not
16 always. The reason I say it is two-
17 dimensional is because sometimes you can
18 get one part of it but not the other.

19 All right? In other words, if it is
20 purely a cost reducing technological
21 change, then you can get the demand part."

22 Of course, this isn't a cost-reducing
23 technological change. Then he goes on to say:

24 "Alternatively, if there are 16
25 different technologies all in the process

1 of being developed, you can maybe even
2 identify them. But you don't know which
3 one of them would have won in the
4 marketplace and so that's the side in
5 which the technology can be speculative."

6 This is their own expert admitting that
7 what would have happened but for Microsoft's
8 allegedly anticompetitive conduct is nothing but
9 speculation.

10 Setting that aside and going to the
11 question of let's assume that a person does have the
12 right to be compensated for a security vulnerability,
13 and, of course, that would be true only if the
14 plaintiffs didn't have to speculate on what the
15 alternative world would look like. But let's set
16 that one aside for a moment. The question is how can
17 you prove that on a classwide basis? The answer, of
18 course, is you can't.

19 What's the evidence on that? The evidence
20 is that Professor Stefan Savage, who is a computer
21 expert at the University of California in San Diego
22 explains in declaration, which is attached to our
23 papers, Your Honor, and it's attached at Tab O to
24 Appendix 1, attached to the papers that we submitted
25 with our motion to decertify. In very simple

1 language, Professor Savage explains why it is that
2 you can't simply use classwide measures for this.

3 He says, first of all, that these
4 vulnerabilities were a fact of life for all software
5 producers, as I explained a few minutes ago. That
6 comes from Professor Savage. You find it all over
7 the industry, he said.

8 Secondly, then, these security
9 vulnerabilities have even been found in security
10 software. People buy software -- I do this myself --
11 buy software from companies like McAfee, for example,
12 and others, Symantec. These are companies that make
13 software that is designed to make your computer more
14 secure. Those companies' security software have been
15 found to have security vulnerabilities as Professor
16 Salvage noted. So this is not something that is just
17 Microsoft, by any means, but he then goes on to say
18 that in order for a security vulnerability to cause a
19 problem, two things have to have happened.

20 First of all, you have to be exposed to it.
21 And, secondly, it has to cause you some harm. Well,
22 most people are exposed to security vulnerabilities
23 if they are connected to the Internet, and few people
24 are exposed to security vulnerabilities if they
25 aren't.

1 Well, it turns out that a surprising number
2 of computer users right here in Iowa are not
3 connected to the Internet during the class period.
4 We have data from 1998. This is the U.S. Census
5 Data, which Professor Noll, by the way, said was
6 "about as good as it gets." That's from Professor
7 Noll's deposition at page 196. So this U.S. Census
8 Data which is as good as it gets, according to the
9 plaintiffs' expert, said that in 1998, 190,000 Iowa
10 households with computers were not connected to the
11 Internet.

12 Now, how could the plaintiffs possibly on a
13 classwide basis show that those 190,000 households,
14 which would include who knows how many class members,
15 suffered some harm from a security vulnerability when
16 they are not even connected to the Internet, which is
17 the usual way you get security problems? And even in
18 2003, which is the most recent data we have, there
19 are about 93,000 Iowa households with computers but
20 no Internet access. So that's the first issue, is if
21 you might not even be exposed.

22 Secondly, some of these security
23 vulnerabilities only exist in certain pieces of
24 software but not everybody in the class uses. So,
25 for example, some of these patches that the

1 plaintiffs point out and say people should be
2 compensated for for installing are for Microsoft
3 Outlook or Outlook Express, and those are Microsoft
4 e-mail systems which sometimes come with the office
5 program.

6 Well, a lot of people don't use those. So,
7 again, even if you're connected to the Internet but
8 you don't use Outlook because you've used your own
9 e-mail system -- you might use Hotmail or MSN mail or
10 Google mail or whatever, AOL, whatever -- you
11 wouldn't be exposed to a security vulnerability that
12 was specific to Outlook or Outlook Express, and some
13 of them were according to Professor Savage.

14 Still other people use security software.
15 They buy security software from somebody else that
16 solves these problem, even if you don't install a
17 patch. And so at paragraph 23 of his declaration, he
18 cites an example of a company -- of a program called
19 "Digital Vaccine," from a company called
20 "TippingPoint Technologies." And if you use that, it
21 provides the same kind of protection that would come
22 to you from all these patches.

23 So there's a myriad of ways of not being
24 exposed at all to these allegedly security
25 vulnerabilities and protecting yourselves from them.

1 But, of course, the point here is that this
2 is all very individual. You know, how I have my
3 computer set up and how Mr. Hagstrom has his computer
4 set up, these are all very different things, and the
5 risk that I or anybody else suffers is very different
6 depending on all these things.

7 Now, in addition, of course, to even being
8 vulnerable, let's suppose a person is connected to
9 the Internet, but let's suppose that a person doesn't
10 download a patch and let's suppose that they get
11 attacked by a virus. The question then is: What
12 harm did it do? And the answer to that, of course,
13 is very individual. It may be something that -- one
14 of these joke viruses that says "Happy Birthday" on
15 your screen or something like that or it may be
16 something that wipes out your data.

17 The difference in the damages that a class
18 member would be entitled to if there were liability,
19 of course, is enormous. So you first have the
20 question: Was the person hurt at all? And that is a
21 highly individual question.

22 And the second question, of course, is: If
23 they were hurt, how much was it? Both of those are
24 highly individual and it couldn't be done on a
25 classwide basis.

1 Now, the plaintiffs, of course, just assume
2 all that away, and they do it by hiring an economist
3 who simply says, "Well, Microsoft recommends that
4 people install these patches, and so we're going to
5 assume everybody should do that and that is why I'm
6 going to take the amount of download time and the
7 standard wage rate and all of that."

8 Even if you were to go down that road,
9 which there's no basis for doing so because it
10 violates the rule in Iowa that actual damages are all
11 that are recoverable, there wouldn't be any basis at
12 all for awarding damages, assuming injury, or
13 awarding damages like the plaintiffs do, because a
14 lot of these patches can be installed automatically.

15 The plaintiffs' expert acknowledged that
16 Microsoft has done a good job of automating the patch
17 downloading process. There's a feature called
18 "automatic update." I have it on my computer, and
19 what it does is it automatically downloads on my
20 computer every single update that Microsoft makes
21 available. I don't have to do a thing. It just
22 happens. At night when my computer is turned on, the
23 patch gets downloaded automatically. I do nothing
24 whatsoever.

25 That means that even under the plaintiffs'

1 world, the time I invested, the time I lost in
2 downloading the security patch, for which I should be
3 paid, is zero because I didn't have to do anything.
4 Many users use that, many companies use it. Many
5 people don't spend any time whatsoever downloading
6 patches and, therefore, haven't been injured even if
7 you were to assume everything else that the
8 plaintiffs -- that the plaintiffs do.

9 So, Your Honor, I will conclude my
10 presentation of the security issue there. There is
11 simply no basis for thinking on a classwide basis
12 that there could be any classwide proof to show that
13 these security vulnerabilities are common, that you
14 could prove that Iowa class members were injured on
15 account of it on a classwide basis. That is, you
16 can't prove impact. You can't prove they suffered
17 any harm at all from any security vulnerability. And
18 even if you were to assume that there was some harm
19 or that you were to prove it on an individual basis,
20 you would still have to ask on an individual basis:
21 How much harm did you get?

22 I said at the beginning that the plaintiffs
23 had three new damage claims here. One was lack of
24 product choice, which they give up on. The next was
25 exposure to security vulnerabilities, which I just

1 covered, and the third was induced innovation in the
2 computer software.

3 Now, the theory here is, I guess, if
4 Microsoft hadn't done what the plaintiffs say is
5 anticompetitive, then more innovative features would
6 have been available somehow on people's computers.
7 Again, this is not a claim that the price was too
8 high, which is the kind of claims that have been
9 here. This is some other kind of claim.

10 Once again, Professor Noll, who is the
11 plaintiffs' expert on this, acknowledged that this
12 was just speculation. He admitted in his deposition
13 that he doesn't "know how to estimate the monetary
14 damage to a consumer in 2006 who is using a product
15 that would have advanced more in a competitive world
16 than it has in a less competitive world." He says,
17 "My experience has been that is virtually always
18 impossible to estimate." That is Professor Noll at
19 pages 145 and 146 of his deposition. I don't think I
20 need to say anything more about the claim for reduced
21 innovation.

22 Your Honor, that brings me to the last
23 point, which is the point about pass-through. And
24 that, of course, is the ground on which the original
25 class certification battle was waged here in this

1 courtroom three years ago and on which the appeal was
2 taken to the Iowa Supreme Court. And if nothing had
3 changed, of course, we wouldn't be here right now.
4 But something did change, a tremendous amount changed
5 so much. So much so that we can now see that what
6 the plaintiffs originally promised, they weren't able
7 to deliver.

8 The reason pass-through is important is
9 because, as the court knows, Microsoft doesn't sell
10 directly to end users for the most part. And so all
11 of the class members are what are called "indirect
12 purchasers" meaning they bought from somebody else,
13 like Mrs. Larsen who bought from Sam's Club or
14 somebody who buys a computer -- it looks like the
15 court reporter has a Dell computer, that's right,
16 that computer probably came from Dell. It came with
17 Microsoft Windows. If it has Windows, it came with
18 it preinstalled. So Microsoft sells to Sam's Club or
19 Microsoft sells to Dell or Microsoft sells to a
20 distributor who sells to Sam's Club who sells to the
21 individual, whatever the channel is, however many
22 levels there are, and there are many.

23 The point is that nobody in the class
24 bought anything directly from Microsoft. So the
25 question, then, is if Microsoft overcharged, the

1 people that it sold to, which are principally the
2 computer manufacturers and also all these
3 distributors and, you know, stores of various kinds,
4 if Microsoft overcharged them, what did they do with
5 the overcharge? Did they absorb it themselves and
6 pay it out of their own pockets or did they pass it
7 on to their customers? That is an essential question
8 here because if the reseller absorbed it him or
9 herself and didn't pass it on to the customer, then
10 the customer, who is the class member, wasn't hurt.

11 And if the customer wasn't hurt, they have
12 no claim under Iowa's Competition Law. And if can't
13 be determined on a classwide basis, then there's no
14 basis for going forward with the class.

15 Now, the plaintiffs' theory on which the
16 class was certified was to have their economists, at
17 that time Professor MacKie-Mason from Michigan, say
18 that he's confident that they'll be able to show that
19 all resellers pass through their cost changes 100
20 percent of the time, always. So if that were true,
21 if every reseller uniformly passed through every cost
22 increase and included this alleged overcharge, then
23 there wouldn't be an issue. It would be class wide
24 because every dime that Microsoft charged would be
25 passed on, if that were true, and he said it was

1 true. He said he was confident, he believed that it
2 was true in the plaintiffs' case. He even said that
3 according to economic theory, the resellers "must"
4 pass on a super competitive price, meaning an
5 overcharge, to their customers.

6 Well, at that point we didn't have any
7 evidence from the resellers themselves. Now we do.
8 We have resellers who have testified right here in
9 Iowa that they, in fact, don't pass these costs on.

10 Now, this is a critical point for indirect
11 purchaser class actions and many indirect purchaser
12 class actions have foundered on exactly this point.
13 Many have either been denied certification or have
14 been decertified on exactly this point, depending on
15 how much leniency the court was willing to give to
16 the plaintiffs in the early stage of the litigation,
17 depending on how many facts were available later on.

18 In the Microsoft cases alone, three
19 different courts have denied class certification on
20 this very point. The Michigan Court of Appeals in
21 the A&M v. Microsoft case denied class
22 certification -- actually, it reversed the trial
23 judge who had granted class certification. This is
24 A&M v. Microsoft, which is 654 N.W.2d at page 572,
25 begins on page 572. Subsequent to that, another

1 Michigan court, a trial court, denied class
2 certification in a case called Fish v. Microsoft.
3 And, of course, a trial court in Maine also denied
4 class certification in the claims brought there.

5 Now, of course, more have gone the other
6 way. More courts than these have granted class
7 certification as the Iowa court did in order to give
8 the plaintiffs more of a chance to prove what they
9 wanted to show, but very few courts have had the
10 opportunity to consider what happens on a full record
11 once discovery is over and the case is ready to go to
12 trial. That's where we are now.

13 The evidence we now have is that the
14 resellers, contrary to Professor MacKie-Mason's
15 theory, don't all act the same. And it's not real
16 surprising that that would be the case because these
17 companies are very different. You have huge
18 companies, for example, these large account resellers
19 that I mentioned before of which there are only 18 or
20 so in the whole country, and they are selling
21 millions and million of licenses. That's big
22 business. They act one way. You have mom and pop
23 resellers, you know, here in small towns in Iowa, who
24 may act in an entirely different way. You have
25 retail stores like Best Buy or Target or stores like

1 that which act in certain ways depending on who their
2 customers are, who they are competing against, things
3 like that.

4 You have computer makers that act in a
5 different way. You have a company called Dell which
6 sells directly to the public. You have other
7 computer makers that sell through stores. They all
8 have different ways of doing business and different
9 ways of making money. It's hard to imagine that all
10 of them would act exactly the same way and, in fact,
11 they don't.

12 So what is the evidence we have on that.
13 The evidence we have comes in two places. One is
14 what to my way of thinking is the best kind of
15 evidence you can have, which is to ask the resellers,
16 "What do you do? Do you always pass through your
17 cost increases or decreases or don't you?"

18 Well, we did that. We submitted
19 declarations from eight resellers located here in
20 Iowa, in large cities in Iowa, small towns in Iowa,
21 all across the state, and those reseller declarations
22 are attached to our class certification papers in the
23 appendix.

24 Now, Your Honor, those resellers asked that
25 their data be held confidential. So I'm not going to

1 use their names here on the public record, but the
2 names for everything I'm going to say, of course, are
3 in the papers, and they are all specifically cited to
4 the declaration so the court can check anything I'm
5 going to say.

6 Let me just give the court a few examples
7 of what the reseller said. All eight of them said
8 that they sometimes absorbed costs changes. Not a
9 single one of those eight resellers said they
10 uniformly passed on the cost changes, not a single
11 one.

12 Here are the various ways in which the
13 resellers testified that they absorbed. One of them
14 said that he had six basic models of computers. He
15 hasn't changed the price for 18 months. He kept it
16 completely the same, even though his cost had
17 changed. He absorbed the difference.

18 Another reseller located in one of the
19 large cities in Iowa said that he had been selling
20 the same computer for \$995 for three and a half
21 years. He said that his costs had gone up by as much
22 as \$50 during that time, but he chose not to pass it
23 on. He simply absorbed it. And that \$50, of course,
24 is in the range of what the plaintiffs claim the
25 overcharge is in this case.

1 Another reseller who has stores in three
2 smaller towns in Iowa said that they refrained from
3 raising prices when their cost changed because their
4 small town clientele expects price stability, and the
5 word gets around. If they raise the price, the
6 neighbors know about it and they go somewhere else.
7 So, again, they absorb cost changes.

8 Another one located in, again, in one of
9 Iowa's larger cities, said that they set the price
10 not based on their costs but by looking at what is
11 available on the Internet because they know their
12 customers could shop there if they want to. So that
13 reseller sets his price according to what a certain
14 product is on the Internet, and he says that he
15 absorbs cost changes up to \$40. He just eats them,
16 absorbs them himself instead of passing them on.

17 So all of this shows that out of the
18 resellers' own mouths they don't uniformly pass on
19 cost changes.

20 Now, the plaintiffs, I'm sure, will say,
21 "Well, sure, it may be true they don't pass on cost
22 changes for a little while, but eventually they have
23 to react." Well, that may or may not be true, but
24 it's irrelevant. And the reason it's irrelevant is
25 because the plaintiffs allege in their complaint that

1 Microsoft engaged in various anticompetitive conduct
2 over a long period of time. In the original -- the
3 third amended petition, as I pointed out, most of the
4 allegations are before 1999. In the fourth amended
5 petition there are allegations about conduct after
6 that.

7 That conduct, if the plaintiffs are right,
8 had consequences. It either raised the price or it
9 kept the price from falling.

10 So if Microsoft allegedly did
11 anticompetitive things to keep Netscape out of the
12 market -- let's suppose that the plaintiffs prove
13 that -- and let's say that happened in 1996 or 1997,
14 well, the plaintiffs have got to show that that had
15 some affect on the price that the computer would have
16 sold for that had Microsoft software installed in
17 that time period.

18 Well, if when that happened a reseller
19 absorbs a cost change, even if it's only for six
20 months or three months or a year or whatever it is,
21 during that period of time whatever overcharge
22 happened at that time gets absorbed and doesn't get
23 passed on.

24 So it really doesn't make any difference
25 if, as the plaintiffs say, there was some sort of

1 overcharge before the class period began and it's
2 still there. There's no evidence for that.

3 The plaintiffs haven't put it on, but they
4 say it over and over, but it doesn't matter because
5 the anticompetitive acts either raise the price or
6 they kept the price from falling. But in either
7 case, a reseller who absorbs price increases and
8 price decreases doesn't pass it on and somebody who
9 buys at that time, whoever it is, isn't injured at
10 all by that anticompetitive act, and the evidence
11 shows that can't be determined on a classwide basis.

12 Now, I've mentioned, Your Honor, what the
13 resellers themselves have said. Now, the plaintiffs
14 point to a couple of other resellers who were
15 deposed -- by the way, several of these resellers
16 have been deposed now and every one of them has stuck
17 to their guns in their deposition and said in their
18 deposition exactly what they said in their
19 declaration. Some of them have even given more
20 examples. There are a couple of other resellers who
21 said that they, in fact, pass on cost increases or
22 decreases.

23 Well, that's our point. They don't all act
24 alike. They are different, and that's why classwide
25 proof simply is impossible here.

1 So the first thing we did was we asked the
2 resellers: What do you do?

3 The second thing we did is we analyzed the
4 data. That is, we took the data that the plaintiffs
5 had subpoenaed from resellers here in Iowa and also
6 from around the country, and we had a distinguished
7 econometrician, Professor Catherine Morrison Paul,
8 analyze the data to see if it backed up what the
9 resellers did.

10 Your Honor, if I can approach the easel, I
11 have some boards which I think will help illustrate
12 this point.

13 THE COURT: Sure.

14 MR. CASPER: So this is an example, Your
15 Honor, of data from a company that makes personal
16 computers. I'm not going to use the name of it
17 because, again, some of this is confidential data and
18 I don't want to put the name on the public record
19 here.

20 This is a model of a personal computer that
21 this company sold for \$1599. From October '99
22 through may of 2000, it kept the price the same.
23 What happened to the company's cost during that time?
24 What happened to the company's cost was that it
25 changed, it went from the amount here a little more

1 than 1250 to an amount of about 1350. I believe the
2 amount of increase is about \$86. That's set forth in
3 Professor Paul's affidavit exactly.

4 So here is a company that for whatever
5 reason decided not to pass on a cost change but to
6 absorb it. So if the company acted the same way with
7 respect to a Microsoft overcharge, you have to assume
8 that they will, we can't have any evidence,
9 obviously, of what a company actually did in response
10 to this hypothetical overcharge. You can only look
11 at what they did with regard to real costs, and you
12 can see here that this company on this model kept its
13 price the same. This company did not pass through
14 that price change for that period of time. They
15 absorbed it.

16 I've got another example. This is an
17 illustration that it's true in both directions, both
18 for cost increases and cost decreases. Again, this
19 company had a computer that it sold for \$1999, and it
20 kept the price the same from January of '99 through
21 December of '99. In other words, the whole year.
22 Now, the price went up in the early part of the year.
23 According to Professor MacKie-Mason, they must raise
24 their price. They didn't.

25 Then the price went down. Then it went

1 back up again. Again, the company didn't respond to
2 these changes in the cost, and that refutes the
3 plaintiffs' theory that they must.

4 The plaintiffs' experts theory about what
5 resellers do is only as good as the factual basis for
6 it, and the facts here show that resellers don't
7 uniformly respond to a cost change by raising their
8 prices. It couldn't be clearer than it is in these
9 examples.

10 And just so that the court doesn't think
11 it's only computer manufacturers. Here is an example
12 from a retail store that has stores here in Iowa.

13 This is a large reseller where you go in
14 and buy things off the shelf. This particular
15 reseller sold -- this is Microsoft Office 2000,
16 standard edition, which is how most people get Word
17 and Excel. And this company kept its price at 19 --
18 I'm sorry, at \$199.99 from October '99 through
19 February of 2000. The whole time.

20 Now, for the first few months it chose to
21 sell that product below cost, and companies do that.
22 For whatever reason they choose, they decide they
23 want to sell it at 1999. They are having a special
24 that day. They want to attract business for other
25 things. For whatever reason they have, companies

1 choose to sell below cost. Here is an example.

2 They sold below cost. Eventually their
3 cost went down. So they lost money here. They
4 started to make a little bit of money. Here the cost
5 dropped. Here it went back up again. What was this
6 reseller's response to all these changes? The
7 response was nothing. Leave the price where it is.

8 So again, the plaintiffs' notion that
9 resellers must respond to cost changes is not right.
10 It's not correct factually, and that's why the expert
11 opinions that we get from those experts aren't worth
12 very much.

13 Now, less the court think I'm cherry
14 picking examples, Professor Paul did an analysis to
15 see if this was true just for a product or two or if
16 it was true more uniformly. She found 2000 examples.
17 In the data set we had 14 resellers that had the kind
18 of data that you could make these comparisons on,
19 that is, they produced their cost for a particular
20 product and their prices for a particular product.
21 There's only 14 of them. And professor Paul analyzed
22 all 14.

23 Just for ease of presentation, I've just
24 put two on this chart. And these charts, by the way,
25 are all in Professor Paul's affidavit or report.

1 These are reproductions of what the court already
2 has. This is to show that this is not just some
3 isolated event. What you've got here with these two
4 resellers: One is a retail store and one is a
5 computer company that sold computers here in Iowa.
6 These are a different grouping of products according
7 to things like operating systems, applications,
8 academic and so forth. They are broken down not to
9 be just a single average, but broken down closer to a
10 product specific basis, although not completely.

11 And what you see here is that the
12 plaintiffs said every reseller has to pass through
13 100 percent. That would be this line here. So if
14 the plaintiffs are right, every point on this graph
15 would be above this line. Of course, a lot of them
16 are below the line. Now, the ones that are
17 statistically significant are blue, and the ones that
18 aren't statistically different than 100 percent are
19 red. So you can ignore the red ones. But the ones
20 that are blue are the ones that passed the
21 statistical test.

22 What you see here is that as you look at
23 these product groups, the various product groups the
24 way they are done, you'll see that companies react
25 very differently. They don't all pass through their

1 costs. The same way with respect to any particular
2 product at any particular time.

3 Now, Professor Netz -- or I should say
4 Dr. Netz. She stopped being a professor some years
5 ago. She is now a full-time consultant. She's
6 plaintiffs' expert on this point.

7 What Dr. Netz has done, which is just
8 simply wrong as Professor Paul demonstrates, is she
9 has made an assumption, which is not supported by the
10 data. She has assumed that a reseller's product are
11 all the same in the way they treat them, and she's
12 done that by doing these regression analyses that
13 only allow one point to be returned, one overall
14 average.

15 So, for example, for this company, this
16 large retail store, this is the result she returned,
17 and it's just over 100 percent. I've forgotten the
18 exact number, but it's 112 or something like that.
19 It's just over 100 percent. She set up the
20 regression analysis to force it to return one number
21 only, which assumes that the company treats all the
22 products the same.

23 But Professor Paul said, "You can't do
24 that. If you're going to allow it to return only one
25 number, you have to first know that the company, in

1 fact, treats the products all the same." If they
2 did, if they -- let's say if they had a uniform
3 policy that they were going to mark up every product
4 by ten percent no matter what, then you wouldn't have
5 to look at individual products.

6 So Professor Paul did what any good
7 econometrician would do. She actually looked at the
8 data to see what it showed, and what she found when
9 she looked at it to see what it showed was that if
10 you break it down into product groups, you find that
11 a lot of the products, in fact, are numbers pass-
12 through, or the relationship between the cost and the
13 price is less than 100 percent, meaning the company
14 absorbs some of the overcharge.

15 And you'll notice, Your Honor, a lot of the
16 numbers are down here below zero percent, which means
17 that there is no correlation at all in a positive way
18 between a change in cost and a change in price for
19 these products. That means that for the numbers that
20 are zero and below for these products if -- let's say
21 Microsoft increased the cost because of its allegedly
22 anticompetitive overcharge by \$10, these products
23 that are represented by these triangles or diamonds
24 down here would have no pass-through of that
25 whatsoever.

1 Now, Professor Netz -- Dr. Netz, I'm sorry,
2 avoids dealing with all of that by just lumping it
3 altogether and allowing it to return only one result,
4 this result, coming up with a broad average that
5 simply doesn't hold for many of the products. And
6 that's not okay when you have a substantive legal
7 requirement that class members can only recover their
8 actual damages because somebody who bought one of
9 these products didn't receive any part of an
10 overcharge that happened during the time that this
11 speaks of. That's what is wrong with what Dr. Netz
12 did.

13 And here for this computer manufacturer,
14 she came up with an overall number of 100 percent.
15 But, again, by averaging it together and forcing it
16 to return only one value, had she done what Professor
17 Paul did, which was to look to see if they are all
18 the same, she would have found out they are
19 different. That's the first failing with
20 Professor -- or Dr. Netz' regressions.

21 Now, just so, again, the court doesn't
22 think I cherry picked some examples, these are all 14
23 resellers for which their is data. And you see the
24 same thing. When you begin to break it down by
25 product group -- and these are not divisions of,

1 like, you know, particular skews, you know, stock-
2 keeping units or products. These are groups such as
3 Office Upgrade or Office Academic or, you know,
4 logical kinds of divisions of products people
5 actually buy in large numbers. When you do that --
6 each one of these, as I said, is a different
7 reseller -- you find exactly the same thing for all
8 of them. You find that the resellers act differently
9 for different products at different times which,
10 again, is not surprising. They are facing different
11 competitive conditions that they may have. They may
12 run a sale on Windows on one day or another or Office
13 another day. For whatever reason, they will react
14 differently.

15 The question that gets obscured here
16 sometimes is what will the reseller do if the price
17 of Windows or Office or Word or Excel goes up on a
18 particular day on account of Microsoft's allegedly
19 anticompetitive conduct? What will they do.

20 A reseller who makes profit in total, of
21 course, sells for more than it pays, and that's
22 really what Dr. Netz showed by forcing an average.
23 She simply showed that on average the company makes
24 money.

25 That's right. They do make money on

1 average, but the question is what happens if
2 Microsoft's anticompetitive conduct raises the cost
3 of Word or Excel or Office? Does that company pass
4 through the cost or do they choose to absorb it?

5 And this data analysis shows unmistakably
6 that companies are choosing to absorb some or all of
7 the cost changes for various periods of time for
8 whatever reasons they have for doing it. They do it.

9 And this supports what the resellers said they do.
10 So it all adds up.

11 And it's very different than the theory
12 that plaintiffs started the case with and the theory
13 that Judge Reis and the Supreme Court affirmed class
14 certification on. Had they done what they said they
15 could do, I wouldn't be here right now, Your Honor.

16 And, finally, let me illustrate another
17 fundamental failing of Dr. Netz' methodology. The
18 first failing was, as I explained before, she allows
19 her regressions to return only one value assuming
20 that every product that that reseller sells is the
21 same, that is, that they respond to a price --
22 respond to a cost change the same way for every
23 product. She didn't look to see -- Professor Paul
24 did look to see and as I said showed you a moment ago
25 they respond differently for different products.

1 Therefore, it's not appropriate to have just one
2 number. That is the first fundamental flaw with her
3 methodology.

4 The second one is this: She included
5 different products that are priced at different
6 levels in the same regression analysis. Again, she
7 lumped -- remember, she lumped everything together.
8 Every product that a reseller sold that she had data
9 for Microsoft products, she lumped them altogether in
10 one regression analysis, one result.

11 If you have a product that sells in this
12 case for around \$100, and if you have another product
13 that sells in this case for around \$200 and you put
14 them in the same regression analysis without proper
15 controls, what happens, as Professor Paul explained,
16 was that the program essentially draws a line between
17 these two cost levels, that is, it averages the
18 difference in how much they costs.

19 That tells me nothing about what one of
20 these companies does when its prices go up or down,
21 and here is the best illustration of that. This is
22 from actual data from a real reseller for purposes of
23 illustration. This only includes two of the
24 projects, and, of course, the reseller sold more, and
25 in the final regression there is a lot more products

1 than this. This is just two of them for purposes of
2 illustration.

3 This particular product, Windows XP
4 consumer, if you look at all the data points that
5 this company sold, you see there is a so-called 11
6 percent price cost relationship. Now, of course,
7 remember Dr. Netz said that there has to be 100
8 percent. Well, there is not. This was 11 percent,
9 you know, very close to zero. So if their cost went
10 up by a dollar, they raised their price by 11 cents.
11 They absorbed the other 91 -- or 89. So if you just
12 looked at this product, you would see there's
13 practically no correlation between a cost change and
14 a price increase, which would say to the plaintiffs,
15 of course, they can't demonstrate a pass-through.
16 Suppose you looked at this product.

17 This is Office 2000 Small Business Edition.
18 Here, the correlation was minus one percent, that is,
19 there was no good correlation between the cost of the
20 product and the price as far as an increase goes.
21 Rather, you actually had a price, very slight price
22 decrease if the cost increased.

23 So for either of these two, if you were to
24 look at those products by themselves, you would say
25 the pass-through is in this case nothing. Here you

1 would say it's 11 percent. Close to nothing. That's
2 what you'd conclude. But what if you put those
3 together in the same regression analysis without
4 controlling for the difference in those two products?
5 You would see, and Professor Paul ran the
6 relationship using Dr. Netz' math, it turns out it
7 returns 111 percent. You would come to the faulty,
8 or as Professor Paul calls it, "spurious" conclusion
9 that the pass-through rate is 111 percent because
10 that is what the regression shows.

11 But the only reason it shows 111 percent is
12 because it's taking two products that have different
13 price levels. If you looked at either one
14 individually, you could see intuitively that's not
15 correct. It's obviously wrong. But when you put
16 this in a regression, that's what you get. And
17 that's the second fundamental flaw with what Dr. Netz
18 did, and Professor Paul chose this very plainly.

19 And again, this corresponds with what the
20 resellers said. They said they don't all act alike,
21 and they don't. And this confirms why it's not
22 proper to simply lump all these things together when
23 they are very different. That's the flaw -- the
24 second flaw in the methodology that Dr. Netz used.

25 THE COURT: Is it okay to take a recess?

1 MR. CASPER: Yes. Yes, Your Honor.

2 THE COURT: 15 minutes. Thank you.

3 (A short recess was taken.)

4 Continue, Mr. Casper.

5 MR. CASPER: Thank you, Your Honor.

6 Before I sit down, Your Honor, I would like

7 to respond to a couple of the points that the

8 plaintiffs made in their resistance to the point we

9 made here. You'll recall the reason for running this

10 analysis was to see if Professor -- or, rather,

11 Dr. Netz was right that all the products were the

12 same, and she clearly wasn't. So the products were

13 separated out to see if the resellers, in fact,

14 looked at them, the same products differently or not,

15 and, of course, they did.

16 The plaintiffs in their resistance said,

17 "Well, what Microsoft did was they sliced and diced

18 the data such that it's not going to produce any good

19 results," and that is not at all what happened. What

20 we did here was we simply took groups that Dr. Netz

21 herself recognized were significant groups, the

22 groups that are used in this column under "b" are

23 operating systems, didn't even distinguish between

24 operating systems. It's just operating systems:

25 Office -- not different versions -- just Office;

1 Word, Excel, Works, and then bundles which are called
2 "Consumer Professional," or standard and upgrades
3 like Academic or Volume licenses. So even if you
4 divide the products at that very gross level, you see
5 that resellers act differently in how they treat
6 those products. That's what this all does.

7 If you then divide the products like a
8 consumer would ordinarily expect to see them divided
9 in a store such as, for example, instead of just
10 operating systems, you ask: Was it Windows 98? Or
11 was it Windows XP? Two different operating systems.
12 You know, with Office, you know: Which version of
13 Office was it? Things like that. If you divide them
14 a little bit more like that, that's what you have in
15 column C.

16 So you can see if you have a very gross
17 definition of products, just to a few or a finer one
18 than what you would really see on the store shelf,
19 what this shows is that in both cases the resellers
20 don't always respond the same if their cost change.
21 That's the point.

22 The only way you can get them to respond
23 the same is to do what Dr. Netz says, which is make
24 them respond the same. Set up the regression so that
25 they would have to respond the same or so it would

1 appear. That's the only way you would get one point
2 above 100 percent.

3 Now, the plaintiffs also say in their brief
4 that when these numbers were run at the extremes they
5 can be so large and so small that they are quote,
6 "absurd," and they cited them, for example, this data
7 point which is minus 88 percent, and then they cited
8 a data point, they took the most extreme one they
9 could find in any one of their regressions, which I
10 think was 1525 percent. And they said no reseller
11 could possibly do that. Obviously, this is absurd.
12 You know, how could Professor Paul even think of
13 doing such an analysis?

14 Well, what Professor Paul explained in her
15 deposition at 130 was that what these numbers tell
16 you is that the reason you have a high positive
17 number or a high negative number, very low negative
18 number, perhaps would be a better way to put it, is
19 because it's telling you that there's no good
20 correlation between a cost change and a price change.
21 So, for example, if a one dollar change in cost would
22 equate, let's say, to an \$8 change in price, a
23 decrease in price, and that would give you a large
24 negative percentage.

25 Well, the reason, of course, isn't because

1 the resellers engaged in some absurd notion that it
2 should reduce its price every time its cost goes up.
3 What Professor Paul said was it's telling you the
4 resellers are doing something on the basis of a
5 reason other than price. They have a different
6 reason for what they are doing. This assumes -- the
7 number that Dr. Netz has assumes that the only reason
8 the resellers do anything is because of price or
9 because of cost. They change their price just
10 because of what their costs are.

11 When you see the lack of correlation, you
12 realize they have other reasons. They meet
13 competition. They want to keep their price at one of
14 those price points like 1599 and not raise it to
15 1699, or they want to have a sale. They want to have
16 -- they want to meet what the guy down the street is
17 doing. They set a price, regardless of what the cost
18 is, and we know from their testimony that they do
19 that. They set prices even though they are not
20 closely correlated to their cost. That's why you
21 have a spread like this, and it's not absurd. It
22 would be absurd only if you believed, like Dr. Netz
23 evidently does, that the resellers have to respond
24 like robots; that every time the cost goes up, the
25 price has to go up.

1 Now, the plaintiffs have a response to all
2 of this that is not unlike their response to the
3 volume licensing. On the volume licensing they said,
4 "Judge, forget the whole thing. There's no
5 typicality in Iowa. Don't even listen to this whole
6 issue." Here, their response is to say, "Forget all
7 of this, Judge, because this is a battle of the
8 experts and you can't engage in a battle of the
9 experts on class certification. You should just
10 forget all of this. This is for the jury to decide.
11 The jury has to decide if Dr. Netz' methodology is
12 fundamentally flawed or not."

13 Well, that is not the jury's role. It's
14 the court's role to decide even under the plaintiffs'
15 cases whether the methodology is fundamentally flawed
16 as this one clearly is.

17 Now, the plaintiffs cite to the cases and
18 the Supreme Court in this case also said something
19 about this, this so-called "battle of the experts."

20 It's absolutely correct that if two experts
21 disagree on the merits of the case, that is, did
22 Microsoft overcharge or did Microsoft not overcharge,
23 that's for resolution at trial. This court has no
24 power to resolve that kind of dispute.

25 But when the dispute is over the question

1 of what is the evidence that is going to be used and
2 will the evidence be individual or will it be common,
3 that's the kind of dispute that the court is charged
4 with with deciding in order to know whether the class
5 certification requirements have been met. A rigorous
6 analysis means exactly that.

7 I can illustrate that best, I think, by a
8 recent case that has close ties to Iowa. You may
9 remember that the Iowa Supreme Court in the Comes
10 opinion dealt with this issue and adopted the view of
11 the Second Circuit, which was articulated in 1981 --
12 or '91, I'm sorry -- in 2001 in a case called In Re
13 Visa/Mastermoney. And the test goes something like
14 this, that the court should decide if the expert
15 opinion is, you know, so flawed as to be
16 inadmissible. I'm paraphrasing, but that's the
17 essence of it. And the Iowa Supreme Court adopted
18 that standard in this case.

19 Well, we're fortunate because the Second
20 Circuit, the same court that articulated that
21 standard that the Iowa court adopted, clarified the
22 case then in a context like this just a few months
23 ago in a case called Heerwagen v. Clear Channel
24 Communications. That case is reported at
25 435 F.3d 219. That's a Second Circuit case from

1 2006. That case like this one is a monopolization
2 case, and the claims there were that a company, Clear
3 Channel Communications, had monopolized the market
4 for concert tickets. So when Paul McCartney comes to
5 town or whoever, the allegation was they were doing
6 anticompetitive things to fix the prices, in effect,
7 for these concert tickets.

8 Well, it was important to whether the case
9 could proceed as a class action whether the market
10 was a national market or whether it was a local
11 market. Just like here it's important to know
12 whether all resellers act the same or whether they
13 act differently.

14 A fundamental factual question, and the
15 plaintiffs, of course, who wanted a class certified
16 had an expert who said, "Oh, no, it's all national.
17 They all act alike. Judge, you shouldn't decertify
18 the class." The defendants said, "No" -- had an
19 expert who said, "No, it's not all national. In
20 fact, if you look at the facts, like looking at the
21 facts here, you'll see that there's a lot of
22 difference from one community to another." It's
23 really not all the same.

24 Well, if the plaintiffs are correct, what
25 the judge would have done in that case would have

1 simply said, "I'm not going to hear this dispute, you
2 know, I'm just going to accept what the plaintiffs
3 expert tells me unless it's so flawed as to be
4 totally inadmissible.

5 That's not what the judge did. What the
6 district judge in the Second Circuit did was he held
7 a three-day evidentiary hearing, and he listened to
8 both experts and he analyzed the facts behind their
9 opinions and the opinions themselves and at the end
10 of the three-day hearing, he found that the defense
11 expert was, quote, "much more persuasive" and he
12 denied class certification because he was not
13 convinced that the market was national but rather
14 local and, therefore, the evidence wouldn't be
15 common, that it would be individual.

16 Now, the plaintiffs, of course, thought
17 they were in great shape because they had the Visa
18 case, which the Iowa Supreme Court has adopted, and
19 they thought that was wrong under Visa.

20 Well, the Second Circuit held that it was
21 not wrong under Visa. The Second Circuit affirmed
22 what the district judge did there and pointed out
23 that there's a big difference between a dispute
24 between experts that goes to the merits of the case,
25 which the court should not resolve, and one that goes

1 to whether the class certification elements, like
2 whether the evidence will be individual or common, is
3 going to be in the case. That's a significant
4 difference.

5 As the Second Circuit said in affirming
6 this decision, whether defendant is liable for
7 monopolization and whether issues common to the class
8 are likely to predominate are sufficiently distinct
9 that the district court did not prematurely rule on
10 the merits by weighing the experts' testimony. In
11 other words, under the standard that the Iowa court
12 adopted, the judge did exactly what he should have
13 done in holding that three-day evidentiary hearing
14 and adopting the view of the defendant's expert, who
15 was more credible.

16 As the Second Circuit said, the district
17 court did not improperly rule on the merits. It "was
18 resolving the sufficiently independent question of
19 whether plaintiff had made a proper showing of
20 predominance."

21 That's exactly what we're asking the court
22 here today to do. We're asking the court to decide
23 as a factual matter whether the analysis that
24 Dr. Netz has done is flawed because it doesn't take
25 account of the facts. The facts of individual

1 differences that are in the record now that weren't
2 there before and make that determination.

3 We're not asking the court to referee a
4 battle of experts over the merits of case. We're
5 asking the court to decide a class certification
6 issue, and the Second Circuit in a case under -- that
7 decided -- which clarified the Visa/Mastercard case,
8 which the Iowa court adopted, has made it clear
9 that's exactly what the court ought to be doing.

10 The other thing that the plaintiffs say in
11 an effort to dissuade the court from even getting
12 into all of this is that it's really okay to use some
13 kind of average major. "Judge," they will say to
14 you, "You don't need to look and to see what any
15 individual class member -- how they were harmed. You
16 don't really need to look and see if the pass-through
17 rate was different for Office, from Best Buy than it
18 was for Windows from Dell. You don't have to look at
19 any of that because we're simply going to allow
20 aggregate damages. We're going to ask you for one
21 lump sum of aggregate damages, and maybe it will be
22 broken down in some fashion by year or by product or
23 something like that, but all we have to do is have
24 some aggregate sum." And they argue at some length
25 in their brief why an aggregate damage measure is

1 really okay.

2 Well, they cite only two significant
3 sources for that. One is an Iowa case, and the other
4 is the Newberg treatise.

5 The Iowa case really supports the point
6 that we make here, which is that under Iowa law
7 aggregate damages are not okay when the statute says
8 actual damages.

9 The case they cite was called Peterson v.
10 Davenport Community School District, at 626 N.W.2d
11 99, which is an Iowa case from 2001, and that was a
12 case that, in effect, reversed an award of aggregate
13 damages. There, this was a case involving a school
14 board and the school board had adopted some new
15 instructional programs. And it doesn't say why, but
16 you get the idea that people didn't like them, maybe
17 because how much it cost. That is not in any
18 opinion, but there was a challenge to these new
19 instructional programs. And in the process of
20 resolving this challenge to these programs, the local
21 folks wanted an election, and the board didn't want
22 to give them one. The court ultimately held that
23 constitutional due process rights were violated
24 because the court didn't give them the procedures
25 that they were due. So they brought an action to

1 seek redress for their constitutional rights.

2 Well, the substantive law is that you get
3 nominal damages if your constitutional rights are
4 violated, even if you can't prove other kinds of loss
5 like emotional distress and things like that. At a
6 very minimum you get nominal damages.

7 The court there, the district court,
8 awarded nominal damages to the class as a whole and
9 the Supreme Court reversed that and says, "You can't
10 do that because this is a situation where each
11 individual would be entitled to damages separately."
12 There's nothing aggregate about this. This is a
13 situation where people's rights were allegedly
14 violated, and the court reserved the award of
15 aggregate damages to the class as a whole and
16 required the district judge instead to award nominal
17 damages to each individual class member. Well, the
18 same is true here.

19 The only way to prove what the damages are
20 is to look and see how class members were injured.
21 And you have to look at what the channels are that
22 are different, and we've already seen that different
23 resellers act differently. So we're not saying you
24 have to look to see what each individual class member
25 experience was, but we are looking to demonstrate

1 that you have to consider the channels that are in
2 fact different. And we've shown persuasively that
3 different resellers act differently. They act
4 differently for different products. They act
5 differently in different points of time. There's no
6 such thing as a measure of aggregate damages to
7 demonstrate that. It flies in the face of Iowa law,
8 which provides for actual damages.

9 The Supreme Court in our case touched on
10 that a little bit too when the Comes opinion said at
11 page 322, "In this case, the plaintiffs must prove
12 that Microsoft violated the Iowa Competition Law, and
13 this violation caused class members to suffer
14 identifiable harm and damages." Very close to the
15 statutory language of actual damages, not some kind
16 of aggregate damages approach.

17 The other source plaintiffs cite for this
18 so-called "aggregate damages approach" is the Newberg
19 Class Action Treatise. But the Newberg Class Action
20 Treatise actually acknowledges that if you have a
21 monopolization case, any kind of aggregate damage
22 award is much less likely to be possible because the
23 differences that take place in a monopolization case,
24 and especially here where you've got the pass-through
25 issues, that it's simply not likely to be possible to

1 have damages for the class as a whole because they
2 will be different, according to the individual class
3 members.

4 As the Ninth Circuit said a long time ago
5 in a case called In re Hotel Telephone Charges, which
6 is 500 F.2d 86, it says, "Allowing gross damages by
7 treating unsubstantiated claims of class members
8 collectively significantly alters substantive rights
9 under the antitrust actions. Such enlargement or
10 modification of substantive statutory rights by
11 procedural devices is clearly prohibited by the
12 Federal Rules Enabling Act that authorizes the court
13 to promulgate the Federal Rules of Civil Procedure."

14 Well, that principle is just as effective
15 here as it is elsewhere, which is that the class
16 action is a procedural device and you can't change
17 the basic law, which is that the class members are
18 entitled to actual damages, by just awarding some
19 aggregate sum to the class as a whole if you can't
20 tie it back to individual injury, and that violates a
21 cardinal principle.

22 The Eighth Circuit ruled similarly in a
23 case called Blades v. Mansanto, which I cited
24 earlier. The Eighth Circuit said here, "Damages to
25 all class members must be shown to justify the class

1 action." Again, not just some sort of aggregate
2 damage measure, but to all class members. That's at
3 400 F.3d at page 571, and that court went on to say
4 at page 573, "Each plaintiff must be able to present
5 evidence from which a jury could reasonably infer
6 that the competitive price was less than the price
7 the plaintiff paid."

8 Again, looking very sensibly under a
9 statute such as Iowa's which requires actual damages,
10 a plaintiff, whether it's a class member or an
11 individual, must be able to show that that plaintiff,
12 that class member, actually paid a higher price. In
13 this case by virtue of having a cost pass-through the
14 reseller chain to that person. There is simply no
15 justification for allowing aggregate average sorts of
16 damages in this case.

17 There's another Iowa case that is important
18 here too, which is the Supreme Court's opinion in
19 Dealers Hobby, Inc., v. Marie Ann Lynn Realty Co.
20 That's a 1977 case which appears at 255 N.W.2d 131,
21 and that was a case in which the Iowa Supreme Court
22 made it clear, under general damage principles, that
23 the plaintiffs' damages are limited to actual losses.
24 Again, you have to tie damages to actual losses, and
25 that's not even under a statute that requires actual

1 damages here. That was just under general Iowa
2 principles of loss.

3 And if that isn't enough to seal the deal,
4 a district court in Carroll County in a case called
5 Farmers Coop. Elevator Co. v. Akzo Nobel in 2004, the
6 district court had before it an indirect purchaser
7 case like this one and had to resolve this question
8 of what does actual damages mean under the statute.
9 And the court in that case held that actual damages
10 under Iowa law means actual loss. It means you have
11 to have the class member prove what the class member
12 actually lost. It's not okay simply to have some
13 aggregate damage measure.

14 Your Honor, on all three points that we've
15 covered, I think we've successfully demonstrated that
16 the class that was certified is simply not the same
17 as the class that is before the court. The facts
18 regarding volume licenses were not before the court
19 when it ruled on class certification. Now they are.
20 And we know that volume licenses are very different
21 than individual licenses. We know that Iowa law
22 requires that claims of the named plaintiffs must be
23 similar to the claims of the class members. The
24 volume licenses should not be part of this class
25 action even if the class actions were to continue.

1 We know that these new claims for security
2 vulnerabilities, which were never before certified,
3 are inherently individual claims. Plaintiffs' own
4 experts have called much of these new claims
5 speculative. But even on the security claim, which
6 they claim to have a common way of dealing with the
7 claim by awarding people the average Iowa wage for
8 the average amount of time it would take to download
9 a patch if you were dialed in on a telephone line,
10 there's clearly no way that one can recover actual
11 loss on a classwide basis using that kind of cause of
12 action on those kinds of theories.

13 And, finally, on the pass-through issue,
14 which this court resolved and the Iowa Supreme Court
15 heard years ago, there's now evidence in the record
16 to show that what the plaintiffs promised and what
17 they said must be true is not true.

18 And for those reasons, Your Honor, we would
19 ask that the court use its discretion to decertify
20 the entire class, and at a very minimum, to eliminate
21 the volume licensing customers and also the new
22 claims for security breaches and lack of innovation
23 from the class.

24 Thank you, Your Honor.

25 THE COURT: Thank you.

1 Response.

2 MR. HAGSTROM: Thank you, Your Honor.

3 It is simply amazing to me that we can sit
4 here and listen to argument by Microsoft counsel
5 about changes between 2003 and the present changes
6 that absolutely do not exist.

7 For instance -- and I will get into this in
8 greater detail a little bit later -- Mr. Casper just
9 told you two minutes ago that the volume license
10 issue was not before the court when Judge Reis
11 certified the classes or when the Supreme Court
12 affirmed that class certification.

13 As you will see as we go through this
14 argument today, Microsoft made the very same
15 arguments.

16 You will also see that these large account
17 resellers, the affidavits that Mr. Casper referred
18 to, are dated 2002 or 2003. The same arguments were
19 made. There's been no changes of fact.

20 Mr. Casper suggests that Professor Noll
21 testified that the security damages are speculative.
22 He did not. He was asked some general questions
23 about innovations. He's not a damage expert. He was
24 not asked to render an opinion on damages. He does
25 not do damages. He's a liability expert. So I

1 clarified with him at the end of the deposition, I
2 asked him "Question" -- this is at page 246 --

3 "I want to turn to your discussion
4 with Mr. Tulchin about innovation. Were
5 you giving -- in that discussion were
6 you giving any testimony about the
7 feasibility of computing damages for
8 class members as a result of security
9 breaches?

10 "No, no. I was talking solely
11 about placing values on improvements in
12 functionality. The security issues were
13 separate. The aspects of his report
14 and the other Smith report that dealt
15 with security is not what I was talking
16 about. I was talking about improvements
17 in the product."

18 And his report was referred -- he was
19 referring to Dr. Gowrisankaran's report, who you
20 heard about in the motion for summary judgment
21 brought by Microsoft concerning this very issue:
22 Security damages.

23 "Have you read" -- excuse me -- "Have
24 you rendered any opinion as to how
25 Dr. Gowrisankaran has computed damages to

1 class members.

2 "No, I haven't read his report that
3 carefully to have any opinion one way or
4 the other about the security aspects of
5 damages."

6 Yet Mr. Casper told you that Mr. Noll,
7 Professor Noll specifically said the security damages
8 claims are speculative. He did no such thing.
9 Mr. Casper also told you "Gee, there's been many,
10 many changes over the course of the last few years.
11 Now, the volume licenses make up 60 percent of the
12 licenses sold in Iowa." That may be true. When the
13 class -- when the class certification motion was
14 brought in front of Judge Reis, Microsoft fought
15 tooth and nail not only with regard to volume license
16 issues, but also to cut off the class period as of
17 December 15, 2001. We said, no, number one, we're
18 already into 2003 and what is appropriate is to carry
19 the class period up to shortly before trial.

20 Judge Reis agreed. Naturally, if you
21 carry the class period shortly up to a point before
22 trial, you are going to have additional purchases.
23 You're going to have additional volume purchases,
24 you're going to have additional non-volume purchases.
25 Nothing new. The issue was previously argued and

1 rejected, not only by Judge Reis, but the same
2 argument was made to the Iowa Supreme Court and it
3 was rejected.

4 Now, what is very interesting about the
5 argument today, among other things, is the lack of
6 discussion about the Iowa Supreme Court's decision in
7 Comes, this case. That decision is controlling.
8 What Mr. Casper also failed to discuss was Judge
9 Gordon's decision on decertification in Minnesota.
10 Microsoft made the same arguments there.

11 Let me just hit some other generalities
12 before going through this step-by-step.

13 Mr. Casper said the products are different.
14 Well, I'm one of plaintiffs' lead counsel here, and I
15 can assure you the products are not different. The
16 class was certified based upon the Windows operating
17 systems going back to MS-DOS and carrying up through
18 Windows XP. The products are the same.

19 Word processing; Microsoft Word, the
20 product is the same. Spreadsheets; Microsoft Excel,
21 the product is the same. Office Suite, you have the
22 different versions of Office up to the current
23 version of products are the same. There is no class
24 for damages regarding, I think he said, Dynamic Web
25 Services, embedded devices or work group servers.

1 There is no damage claims for those. They are
2 mentioned in the modified fourth amended petition
3 because Microsoft's conduct with regard to certain of
4 those products reinforces its monopoly in the
5 relevant applications markets at issue and in the
6 operating systems market.

7 And Your Honor will recall that over the
8 course of the pass couple of years when we've argued
9 motions to compel, Microsoft repeatedly argued in
10 opposition to those motions, well, such and such
11 wasn't in the petition. So what did we do? We made
12 sure that the allegations of conduct were in the
13 petition. That doesn't mean that the class
14 definition has changed one iota. It has not.

15 And, in fact, Your Honor may recall that
16 Microsoft removed this case to federal court when we
17 filed a draft. We brought a motion to amend and
18 based upon that amendment Microsoft removed. And
19 their basis was that they took a couple of clauses
20 out of that draft that said, for instance, with
21 regard to the Burst case, that it was a trademark
22 case or patent infringement case. They say, "Oh,
23 gee, that raises the federal question so we're
24 entitled to be in federal court."

25 We also included allegations about

1 Microsoft's consent degree with the securities and
2 exchange commission under spoliation issues.

3 Again, Microsoft said, "Oh, well, now we've
4 got a securities claim." So they removed it on that
5 basis. We went across town to federal court, and the
6 court there said, "This is ridiculous. These are not
7 federal claims," and sent it back.

8 So what is going on here is the identical
9 thing. Microsoft is trying to take out of our
10 petition clauses concerning its conduct and saying,
11 "Look, judge, everything is new, everything is
12 changed. We've got to decertify this whole class.
13 We've got to start over. We've got to get rid of
14 this trial date."

15 Now, Mr. Casper also cited to Judge Reis's
16 certification -- or, excuse me. On the same date she
17 issued her certification order, she issued a ruling
18 on our motion to compel. And Your Honor remembers
19 some of the issues that have come up with that motion
20 to compel over the course of time.

21 And Mr. Casper recites some language from
22 that. I didn't go back to check the language, but he
23 says, "Well, Judge Reis wrote that you guys better be
24 careful. You plaintiffs better be careful because if
25 you make any changes, you know, this whole class

1 certification is, you know -- might be out the
2 window, whatever she said.

3 Well, what Mr. Casper doesn't tell you is
4 that was Microsoft's order. It wrote it. And I've
5 misspoke. I said it was the same date as the class
6 certification. It was actually the same date that
7 she issued the collateral estoppel rule.

8 Microsoft wrote the order and yet when
9 Microsoft appealed the collateral estoppel issue, it
10 raked Judge Reis over the coals, savaged her for
11 adopting a proposed order written by plaintiffs. And
12 now Judge Reis is just perfect, everything was great
13 in her order that Microsoft counsel drafted.

14 As we will get into in a few minutes,
15 Mr. Casper says, "There's new damages claims." Not
16 so.

17 In our third amended petition, we recited
18 that there was injury to the class members not only
19 in the form of overcharge, but in the form of
20 suppression of innovation, product choice, product
21 quality. Those allegations have been around a long
22 time. They were there when the class motion was
23 first brought before Judge Reis. They were discussed
24 in Professor MacKie-Mason's opening affidavit and
25 reply affidavit. Microsoft fought over those

1 allegations. The class was certified. That
2 certification was affirmed on appeal.

3 Mr. Casper said, "Well, back in class
4 certification, back in 2003, Professor MacKie-Mason
5 was presenting theories. That is all he had.

6 Well, as Mr. Casper well knows back in 2003
7 by the time the class certification filings were made
8 in this case, Professor MacKie-Mason and
9 Dr. Janet Netz had already submitted a voluminous
10 report in the Minnesota case.

11 Professor MacKie-Mason and/or Janet Netz
12 had submitted expert reports in other cases. And in
13 those reports they either individually or together
14 had done numerous pass-through studies, regression
15 analyses. They had looked at other evidence
16 concerning pass-through including admissions of
17 Microsoft's own experts, Microsoft's internal
18 studies, Microsoft's commissioned studies. And the
19 class was certified here based upon all of that
20 evidence. The classes were certified in Minnesota
21 based upon all of that evidence. And Judge Peterson
22 refused to decertify based upon all of that evidence.

23 So just in very quick summary then. Noll
24 never said security damages were speculative. He
25 didn't say innovation damages were speculative. He

1 said he's never done it. The class period
2 contemplated that Microsoft's continuing conduct
3 would be at issue, and class members who happen to
4 make purchases in that additional time frame would be
5 part of the class. Volume license issues were
6 vigorously disputed back at that time, and I should
7 also mention Mr. Casper relies on the Deiter case out
8 of the Fourth Circuit.

9 At the same time we were going through the
10 briefing here, they brought a motion in the MDL.
11 That issue was a hot issue. It was being addressed
12 by Judge Motz at the same time it was being argued
13 here. They prevailed in federal court under reasons
14 I can get into. They didn't prevail here on that
15 issue.

16 So let's take a look at the Comes and
17 Gordon decisions.

18 In Gordon, "We have never suggested a class
19 plaintiff must show there will be common proof on
20 each element of the claim. Rather, we have
21 repeatedly noted that the existence of individual
22 issues is not necessarily fatal to class
23 certification."

24 THE COURT: You mean Comes?

25 MR. HAGSTROM: Pardon?

1 THE COURT: You said Gordon. That's Comes.

2 MR. HAGSTROM: Comes. I'm sorry if I
3 misspoke. We believe the district court's findings
4 on the first three common issues, which Microsoft
5 does not seriously challenge, are sufficient in
6 themselves to justify a finding of predominate
7 issues.

8 Now, Microsoft's motion to decertify --
9 well, let me just comment on this.

10 You heard from Mr. Casper that plaintiffs
11 cannot prove by common proof impact and damages. You
12 can't prove that everybody was injured the same or in
13 the same amount. The Iowa Supreme Court says you
14 don't have to. You don't have to. And we will get
15 into some further quotes on that issue in a minute.

16 Now, Microsoft's motion to decertify,
17 obviously brought on the eve of trial, is really a
18 last minute gambit to walk away from the harm it's
19 caused Iowa consumers over the past 12 years.

20 This is a summary slide of the estimated --
21 or calculated current value damages under the three
22 methodologies used by plaintiffs' damage experts.

23 So you see the total amount, and mind you,
24 this is before trebling under Section 553.12(3). So
25 Mr. Casper was carefully attempting to get you to

1 make some modifications to this class certification
2 ruling. He would like to see volume licensees
3 removed from the case because if we use his 60
4 percent figure -- if I'm doing my math correct in my
5 head -- that knocks off \$270 million off the claim.
6 Boy, Microsoft would sure like to walk away from
7 that.

8 Now, let me be very clear about one thing.

9 Microsoft wants you to modify this class
10 certification order whether by decertifying which, of
11 course, there's an appeal. But even if it's
12 modified, for instance, to remove volume licensees or
13 make some other modifications, Microsoft wins
14 because under Rule 1.265(4) an order amending the
15 certification order is appealable. Mr. Casper didn't
16 tell you that. But that is the game plan here, Your
17 Honor. They want to get some modification so this
18 trial is delayed for who knows how long.

19 As I mentioned before, Mr. Casper totally
20 ignores the Iowa Supreme Court's decision in Comes.
21 The Comes court, just like it's done in many
22 decisions, City of Dubuque, Luttenegger, Vignaroli
23 and others, has repeatedly held that common issues of
24 liability alone are sufficient for class
25 certification.

1 So here, you didn't hear one word from
2 Mr. Casper. You haven't seen one word in their
3 briefs where they've challenged the fact that there
4 are common issues of liability.

5 And for that reason alone, the motion must
6 be denied. That's what the Iowa Supreme Court ruled.
7 The motion must be denied because that is the rule of
8 law not only in Iowa but in this case.

9 Now, as I mentioned, Microsoft made these
10 identical arguments in the Gordon case, and
11 Judge Peterson in a detailed decision went through
12 and rejected each of Microsoft's arguments. And he
13 went through and addressed the damages methodologies,
14 addressed the pass-through issue, addressed these
15 issues that Mr. Casper raises about averages, and we
16 will get into that a little bit later. And in each
17 of those -- he rejected each of those arguments and
18 refused to decertify the class.

19 Now, Microsoft also fails to tell Your
20 Honor about the standards set forth by the Comes and
21 Gordon courts, and fails to tell you about the
22 standards that you need to apply in this particular
23 motion.

24 What the courts make clear is that just as
25 on certification, on decertification the issue is

1 whether or not the elements of the rule, the class
2 certification rule, have been met. Not whether or
3 not the prima facie elements of a cause of action
4 have been met. The latter is for summary judgment.
5 The former is certification.

6 As I mentioned, the Iowa Supreme Court, as
7 does every state court across the country that I'm
8 familiar with, says that common issues of liability
9 alone require class certification even if there are
10 individual questions concerning damages.

11 What we contend, despite what Mr. Casper
12 told you earlier today, there are common issues of
13 impact and common issues on damages.

14 You know, Microsoft asserts that each class
15 member must have suffered impact, otherwise, I think
16 they are saying the class must be decertified. Well,
17 let's just set aside now the issue on liability
18 because on that basis alone the motion must be
19 denied. So we're going to turn to the issues of
20 impact and damages.

21 So Microsoft asserts that each class member
22 must be impacted. So if there's just one out there
23 that wasn't impacted, you've got to decertify. The
24 claims of the millions of purchases out there are
25 just gone. 452 million before trebling is gone

1 because there's one class member out there that
2 supposedly wasn't impacted. Well, that is not the
3 rule.

4 And if Your Honor takes a look at the
5 original Comes decision where the Iowa Supreme Court
6 adopted the indirect purchaser standing rule and
7 rejected federal law, rejected the Illinois Brick
8 rule, the court looked at and cited many pre-Illinois
9 Brick federal cases. And those cases dealt with
10 these very same issues on pass-through, these very
11 same issues on common impact and damages, and they've
12 cited a number of cases where classes were certified
13 and they continue to be certified. They went on to
14 trial, were settled in trial, before trial or
15 whatever.

16 But before Illinois Brick, everything that
17 is going on in this case was commonplace in the
18 federal courts, but since then, of course, states
19 like Iowa, Minnesota, California, several others have
20 said we don't believe in the Illinois Brick rule.

21 We believe that consumers have rights, that
22 consumers ought to be able to pursue indirect
23 purchaser actions. And as a result, close to half of
24 the states, not quite half, have adopted the indirect
25 purchaser standing rules.

1 Now, on the issue of whether or not every
2 class member must be injured, Judge Peterson rejected
3 that. And, for instance, he cited the Northern
4 District of California, the Presidio Gold Club case
5 which states, "the fact that certain members of
6 plaintiffs' class escaped injury altogether would not
7 preclude certification or destroy the class's prima
8 facie case of impact." It's a 1976 decision, 1976
9 Westlaw, 1359 at *5. And that opinion was cited with
10 approval in the NASDAQ Market Makers court and by
11 Judge Peterson.

12 Now, as I mentioned, the decertification,
13 just the decertification, depends on the absence of
14 an element of Rule 1.261 .262 and .263. Mr. Casper
15 didn't discuss one thing about any of those rules, at
16 least I didn't hear it.

17 And when you talk about battle of the
18 experts, the Iowa Supreme Court in Comes said, "You
19 do not engage in a battle of the experts. You do not
20 get into the merits on either certification or, in
21 the circumstance, decertification." Why? Because
22 you have Professor Paul saying one thing, and she
23 says "Oh, Dr. Netz doesn't know what she's talking
24 about."

25 And Dr. Netz says, "Professor Paul doesn't

1 know what she's talking about." It's a battle of the
2 experts. Those go to substantive issues that are for
3 the jury.

4 There's going to be credibility issues
5 between the two, and the jury is going to decide who
6 to believe. The jury is going to decide whether you
7 have Best Buy or any other company that buys products
8 in which they are including the Microsoft products at
9 issue in which there is an embedded overcharge up to
10 60 percent of the cost, and the jury is going to have
11 to decide, "Well, does Best Buy, a successful
12 company, and all of these other companies, do they
13 just give this stuff away?" "Do they not recover
14 their costs when they sell their products?"

15 I'm going to tell the jury, you know, this
16 is going to be easiest issue for you to understand.
17 Companies that stay in business recover their costs
18 and they recover profit margins. So you can try and
19 look at all of these little changes in costs and
20 prices and so forth, as Mr. Casper would have you do,
21 and that's what -- he mentioned three courts. He
22 mentioned the A&M Supply court in Michigan, the
23 appellate court, and I think a subsequent trial court
24 in Michigan and a trial court in Maine. That's what
25 they focused on. They focused on these little tiny

1 price changes and cost changes and whether or not
2 there was a corresponding price change, which we will
3 also get into, is basically a simple regression
4 analysis.

5 Well, they never really understood what the
6 true issue is. The issue is whether or not the
7 overcharge is passed through. Now, Mr. Casper didn't
8 talk to you about that, but we will also get into
9 that as well.

10 Now, Microsoft's ploy here is not unique.
11 The courts routinely reject the standard defense
12 tactic of attacking the merits of the plaintiff's
13 case as part of a defense to class certification.
14 For example, in *Williams v. Brown* at 214 F.R.D.484
15 with a jump cite of 487, Northern District of
16 Illinois 2003, the court in denying defendant's
17 request for class decertification rejected the
18 defendant's challenges as to proof of impact,
19 writing, quote, "Whether the evidence adequately
20 supports plaintiffs' claims is a question properly
21 addressed in the defendants' pending motion for
22 summary judgment, not in the motion for
23 decertification." There was no decertification
24 there.

25 Similarly, the court in *Bogosian v. Gulf*

1 Oil Corp., 596 F.Supp. 62, jump cite 76, an Eastern
2 District of Pennsylvania decision from 1984,
3 similarly ruled that attacks on plaintiffs' experts'
4 proof of classwide impact was an issue not for
5 decertification but, rather, for summary judgment.

6 So we could have the experts come in here,
7 as they will during trial, and the jury will need to
8 decide who to believe. Is it logical that all these
9 successful Iowa businesses simply eat costs as an
10 everyday matter of business operations? I don't
11 think so, and I don't think the jury is going to
12 conclude that.

13 THE COURT: Mr. Hagstrom, we're going to
14 take a break at this time. I have to go to a bar
15 association luncheon meeting; is that okay? Can we
16 resume at 1:15. Is that all right?

17 MR. HAGSTROM: That is great.

18 Thank you, Your Honor.

19 THE COURT: Okay. Take a recess until
20 1:15.

21 (A noon recess was taken.)

22 THE COURT: Mr. Hagstrom, continue.

23 MR. HAGSTROM: Thank you, Your Honor.

24 I just wanted to mention one other thought
25 about the fact that the products currently at issue

1 are the same as the products at issue a couple of
2 years ago with the original class certification, and
3 that is, Your Honor will recall, that we have now
4 spent over a couple hundred thousand dollars on class
5 notice. And the class notice documentation was
6 approved by Microsoft and that, of course, identifies
7 those indirect purchasers who are members of the
8 class.

9 And, of course, the products, as part of
10 that notice, are, in fact, the products that I
11 previously identified: MS-DOS, the window operating
12 systems, Word, Excel and Office. So there was not
13 any embedded devices, no servers, anything like that
14 in that notice.

15 I would like to -- I've talked a little bit
16 about the fact that there's really no change in the
17 facts or the law since 2003. Microsoft, I believe,
18 recognizes the standard that if you're going to have
19 decertification, there must be a material change in
20 the law or there must be a material change in the
21 facts. And we did not hear anything from Microsoft
22 about any material change in the law. We have the
23 Iowa Supreme Court decision, and that has certainly
24 not changed. It's the law of this case.

25 And as I mentioned, Microsoft makes the

1 very same arguments that it made before Judge Reis
2 and the Supreme Court three years ago. These
3 arguments boil down to this: Again, this is on
4 impact and/or damages.

5 I'm setting the liabilities issue aside
6 because there's no -- absolutely no argument by
7 Microsoft that changed liability. And the Iowa
8 Supreme Court has said that common issues on
9 liability alone are sufficient for class
10 certification.

11 So when we look at the issue of impact or
12 damages, Microsoft's argument boils down to resellers
13 do not always and immediately change their prices in
14 response to cost changes; therefore, some resellers
15 do not pass on any of Microsoft's illegal overcharges
16 to indirect purchasers. And from this flawed
17 premise, Microsoft then argues that plaintiffs cannot
18 prove classwide harm using common proof, and
19 therefore the class must be decertified.

20 Judge Reis saw through these very same
21 arguments, certified the class. And as Judge Reis
22 recognized, courts in Arizona, California, Florida,
23 Kansas, Minnesota, New Mexico, North Dakota, South
24 Dakota and Wisconsin all saw through similar
25 arguments by Microsoft and certified classes. And

1 since Judge Reis' opinion was issued and, in fact,
2 since the Iowa Supreme Court's decision was issued,
3 the New York District Court, Supreme Court -- they
4 call it the Supreme Court out there -- has similarly
5 certified a class of indirect purchasers in a
6 Microsoft case.

7 Now, as I stated that tautology that
8 Microsoft presents -- as I mentioned before, one of
9 the critical points in Microsoft's argument is that
10 you must have the overcharge, all of the overcharge
11 passed on to each class member. Let me just address
12 that point for a minute.

13 For purposes of impact, if there was one
14 penny of overcharge to any class member, that's
15 impact. It's minimal, but it's impact.

16 Our expert, Dr. Netz, has done a number of
17 studies and finds that the pass-through rate is at
18 least 100 percent, so meaning that the overcharge is
19 passed through at least 100 percent. In fact, we
20 will get into numerous studies that she has done
21 where the pass-through rate exceeds 100 percent,
22 which means if the overcharge was \$100 to the seller,
23 for instance to Dell computer, and a class member
24 purchases the Dell computer with the software
25 preloaded on it and the pass-through rate is 110

1 percent, the actual cost or overcharge to the
2 consumer, the end user, class member is \$110.

3 Now, let me go to Judge Peterson's decision
4 in Gordon. As I mentioned, Microsoft made the very
5 same arguments there, and just for convenience
6 purposes, I would like to have handed up to Your
7 Honor a copy of the decision in the Gordon case by
8 Judge Peterson and also the Comes decision, the Iowa
9 Supreme Court.

10 It's our view that those two decisions
11 alone -- and, of course, Judge Peterson's decision
12 isn't binding on Your Honor, but it's very helpful
13 in terms of answering the arguments that Microsoft
14 has made in this motion.

15 Now, in Gordon, Judge Peterson appreciated
16 the stakes involved in Microsoft's motion. He
17 recognized the decertification of the classes would
18 be the functional equivalent of dismissing the
19 lawsuit.

20 Moreover, decertifying the classes due to
21 supposed economic complexity would be tantamount to,
22 as he put it, abrogating Minnesota's indirect
23 purchaser statute.

24 So he felt it was important to adopt a
25 reasonable approach in determining whether the case

1 met the requirements of class certification. And as
2 you see on the screen at the first page of that
3 decision, Judge Peterson recognized that decertifying
4 the class would constitute the functional dismissal
5 of a consumer indirect purchaser antitrust lawsuit.

6 And he also recognizes that while there may
7 be economic complexity, that is not a reason to
8 decertify. In any antitrust case, whether as a class
9 or an individual purchaser bringing the antitrust
10 case, there will be economic complexity.

11 Now, like Judge Peterson, the Iowa Supreme
12 Court recognized in the first Comes case that
13 economic complexity is inherent in indirect purchaser
14 cases.

15 You'll see at page 450 of that decision
16 back in 2002 the court said, "It is the indirect
17 purchaser, not the direct purchaser, who is most
18 frequently injured. Therefore, to facilitate
19 enforcement of the policies behind the Iowa
20 Competition Law, indirect purchasers, the real
21 victims, must be authorized to bring a cause of
22 action in state court."

23 And the court went on to address the
24 arguments that Microsoft was making about, "Well,
25 this is just way too complex. We've got these

1 pass-through issues."

2 It said, "We conclude the possibility of
3 complex litigation is an insufficient reason for us
4 to find indirect purchasers must be barred from
5 bringing a state cause of action for antitrust
6 violations."

7 And, of course, the Iowa Supreme Court
8 understood that this was a class action. It's been a
9 class action since its origination, since it was
10 originally filed. So it granted standing to indirect
11 purchasers with the understanding that they are the
12 real victims, they are bringing a class action, and
13 their only means of recovering is through the class
14 action procedural device.

15 Now, the decertification arguments in
16 Minnesota were the same as those now presented here.
17 What we have up here is from the Gordon decision.
18 Judge Peterson wrote at the hearing: "Microsoft's
19 counsel" -- and I might mention that counsel was
20 Mr. Casper -- "highlighted evidence that some
21 intermediate distributors did not automatically raise
22 their prices in response to cost increases.
23 Sometimes they maintained specific focal point prices
24 and absorbed cost increases for several months
25 without changing the price. From this evidence,

1 Microsoft argued that there may be class members who
2 were damaged little, if at all, by monopoly
3 overcharges. Counsel argued that Microsoft is
4 entitled to call many intermediate distributors as
5 witnesses to testify about their actual cost and
6 pricing history. Thus, Microsoft contended,
7 individual issues predominate over common ones and
8 the classes should be decertified or the trial will
9 be unmanageable." Your Honor, virtually the exact
10 argument you heard here this morning from Mr. Casper.

11 Now, Judge Peterson rejected Microsoft's
12 arguments, and he also rejected the concept that
13 Microsoft is going to be bringing in all sorts of
14 resellers. And he did that for a number of reasons,
15 one of which, as I explained to him, the evidence, if
16 it was at all probative, which I argued it would not
17 be, would be cumulative.

18 But more importantly, like Mr. Casper has
19 presented to Your Honor this morning, in looking at
20 some raw data, in other words, looking at a price
21 line like Mr. Casper put up on the chart here this
22 morning with raw data of costs, assuming that that
23 this is all the total cost, that's not a multiple
24 regression analysis. At best, it's a simple
25 regression analysis. It's just tracing raw data.

1 And as Judge Peterson wrote, "Plaintiffs'
2 experts explain that regression analysis identifies
3 the average rate at which the consumer price changes
4 in response to changes in Microsoft prices.
5 Nonetheless, the use of average pass-through rates,
6 even in combination with Microsoft's evidence that
7 individual distributors sometimes absorbs specific
8 cost increases, falls short of suggesting that any
9 significant number of class members escaped injury."

10 Now, let me just clarify something too
11 about the use of the word "average" in terms of
12 multiple regression analyses.

13 We could take the number two and the number
14 six, add them together, and the average of those two
15 numbers is four. But that's not what multiple
16 regression analysis is all about, and that's not the
17 averages here that he's talking about. Microsoft
18 with wordsmithing would like you to think of averages
19 as the former, so that you could have -- you could
20 have a pass-through rate of zero and one at 202 and,
21 therefore, the quote, unquote average pass-through
22 rate is 101 percent. That's not what is going on
23 here.

24 The multiple regression analyses actually
25 controls for numerous variables, various costs, and

1 competition. And you can set these variables and
2 that's what plaintiffs' experts did in doing their
3 pass-through analysis and that's what Judge Peterson
4 recognized.

5 So Microsoft was arguing to Judge Peterson,
6 "Well, look, all you're doing is getting averages."
7 Multiple regression analyses by definition are a
8 quote, unquote, average of data points. But as part
9 of that statistical analyses, you have ranges, and
10 you have confidence levels. And the expert report,
11 Dr. Netz's expert report, as I recall, reports to a
12 95 percent confidence level. And so what you have
13 is -- as a result of those studies, you have pass-
14 through rates in excess of 100 percent or at least
15 not statistically significantly different than 100
16 percent.

17 So for Microsoft to come in here and say,
18 "Well, this is just an average taking wildly
19 desperate numbers and getting an average," that is
20 absolutely false.

21 Now, in this section of his opinion
22 Judge Peterson explains the reasoning behind his
23 conclusion that varying reseller practices do not
24 necessarily result in varying impact to class
25 members. And he focuses on the fact that the

1 monopoly overcharge in this case did not come all at
2 once, but was increased over time. And he further
3 observes that Microsoft collected the overcharge by
4 increasing prices as well as not lowering prices. So
5 the portion of the overall price that consisted of
6 the overcharge was not manifested solely by a cost
7 increase here and there. As he points out, "Even a
8 distributor which absorbed a cost increase might
9 still have reduced its prices if Microsoft had
10 matched a declining competitive price by reducing its
11 price."

12 So what Judge Peterson found, number one,
13 and this is a pretty fundamental point and can be
14 confusing -- I don't know for sure, but I'm pretty
15 confident you own an automobile, Your Honor, and you
16 go to the gas station and buy some gasoline every
17 once in a while. And you probably have wondered,
18 "Gee, down the road one station is at \$2.51.9, and
19 some other station is at \$2.49.9 and then the next
20 day the prices may vary. It might be a few cents
21 higher or a few cents lower.

22 Well, so, in other words, the stations
23 might have, you know, costs that are changing, you
24 know, from their distributor on a daily basis. But
25 with the Microsoft software issue, you heard

1 Mr. Casper talk about, for instance, on the volume
2 licensing: Microsoft's prices don't change. In
3 other words, they are long-term contracts. So there
4 isn't variability in prices. There isn't this sort
5 of chatter at the end purchaser level. So these
6 prices are stable over time, and that's what Judge
7 Peterson recognized. They are stable over time, and
8 they are part or embedded in -- the overcharge then
9 is embedded in this cost that -- which Microsoft
10 sells to its direct purchasers. And when the direct
11 purchasers in turn sell to, for instance, end
12 consumers in the case, for instance, if the direct
13 purchaser was Dell and you buy a Dell computer with
14 the software preinstalled, those direct purchasers
15 are passing on that embedded overcharge, and that's
16 what Judge Peterson recognized.

17 He also recognized that Microsoft --
18 through Mr. Casper -- was arguing, "Wait, a minute,
19 no, no, no," you haven't proved for every one cent of
20 the cost change by some seller to an intermediary was
21 passed through in the form of a one-cent price
22 change. That's irrelevant.

23 It's the chatter because what we're talking
24 about here in terms of an overcharge on the operating
25 system, we're talking about on average over the

1 course of the class period about a \$45 overcharge.
2 And I want to emphasize, though, that is an average
3 because that changes over the course of time with
4 competitive conditions, Microsoft's market share and
5 so forth.

6 So -- or stated another way, you have about
7 60 percent of the price of Microsoft software to its
8 direct purchaser as the overcharge. That's what
9 Dr. Netz finds.

10 So even if you have a situation where
11 you've got \$100 -- we will use simple numbers --
12 \$100 cost of the operating system, the intermediary
13 would have to give it away in order for there to
14 potentially be no overcharge and I say "potentially"
15 because there's marketing situations that I will talk
16 about shortly.

17 But, in other words, if the price instead
18 of \$100 by the intermediary was \$1, you get 60 cents,
19 60 percent of that dollar as the overcharge being
20 passed through. So, therefore, there still is
21 impact.

22 Now, Judge Peterson explains why he rejects
23 the inferential leap pressed by Microsoft, i.e., that
24 one can conclude that there was no pass on of
25 overcharges merely from evidence that they did not

1 pass on cost increases, as I just mentioned. So this
2 case and these other cases against Microsoft are
3 about pass on of embedded overcharges, not just cost
4 increases.

5 So this is why Judge Peterson explained
6 average pass-through rates appear reasonable and even
7 necessary to prove damages here. In other words,
8 what he's saying is the question of what would have
9 happened but for Microsoft's monopoly overcharge is a
10 hypothetical. And a hypothetical question generally
11 cannot be answered by historical data but what
12 actually happened, but must often be answered by
13 general principles about what generally tends to
14 happen. Thus, the average pass-through rates --
15 again, derived from five different types of evidence
16 including regression analysis -- appear reasonable
17 and even necessary to prove damages here.

18 Now, Judge Peterson also explained why
19 class certification was necessary and appropriate
20 even if not all class members were injured.

21 As I mentioned before, he cited the
22 Presidio case and the NASDAQ Market Makers case.
23 But, of course, we submit that all class members were
24 injured by Microsoft conduct because all
25 intermediaries passed on the entirety of the

1 overcharge. But even, like I said, if it was only a
2 fraction of the overcharge, there is still impact.

3 Sorry, that was my computer. It's been
4 being strange the last 24 hours.

5 Now, in the Comes case, we've got one
6 significant difference between Gordon and the Comes
7 decision. In Gordon -- this was Judge Peterson's
8 decision on decertification -- we went to trial, and
9 after seven weeks of trial, the case settled.

10 Well, here this court has the benefit of
11 the Iowa Supreme Court's decision on this issue. And
12 it's precisely the issue presented by Microsoft here,
13 which is whether these plaintiffs using these experts
14 who employ the methodologies that are set forth in
15 the expert reports which were identified in the
16 affidavit submitted to Judge Reis in the Iowa Supreme
17 Court have satisfied the requirements of Iowa's class
18 action rule.

19 So looking at the Comes decision, there is
20 one fundamental premise to the class action rules and
21 that is they are remedial in nature and should be
22 liberally construed to favor the maintenance of class
23 actions, as the Court said at page 320. It also said
24 the appropriate inquiry regarding the status of an
25 action as a class action is not the strength of each

1 individual class member's personal claim, but whether
2 they as a class have common complaints.

3 Now, you recall that Mr. Casper wants you
4 to focus on each class member's personal claim. As
5 the Iowa Supreme Court is saying, that is not the
6 proper focus.

7 It also said we have never suggested that a
8 class plaintiff must show that there will be common
9 proof on each element of the claim. Rather, we have
10 repeatedly noted that the existence of individual
11 issues is not necessarily fatal to class
12 certification.

13 So again, what is being stated is
14 Mr. Casper saying we have to show predominance, that
15 common issues predominate over individual issues as
16 to each element of our claim: Liability, impact and
17 damages. The Iowa Supreme Court said, "Microsoft, we
18 hear your argument. We reject it."

19 Now, here is the argument. "Microsoft
20 contends a showing of predominance is a condition
21 precedent to certification, but we disagree; this is
22 only one of thirteen factors to be considered. In
23 this case, the plaintiffs must prove that Microsoft
24 violated the Iowa Competition Law, and this violation
25 caused class members to suffer identifiable harm and

1 damages." So the Supreme Court is identifying the
2 three broad elements of an antitrust case: You've
3 got the violation, you've got the impact, and you've
4 got the damages.

5 "We believe the districts court's findings
6 on the first three common issues, which Microsoft
7 does not seriously challenge, are sufficient in
8 themselves to justify a finding of predominate
9 issues.

10 "In view of this court's liberal rules on
11 the admission of expert testimony, we cannot say that
12 the plaintiffs' testimony" -- this is the very
13 testimony that Mr. Casper is challenging here
14 today -- "is inadmissible as a matter of law."

15 So it's not being excluded. Now, let me,
16 just as an aside here, say that Mr. Casper told you
17 about the Heerwagen decision out of the Second
18 Circuit. I'm not sure if I'm pronouncing that
19 correctly.

20 In that particular case, there was not
21 certification because in federal court you have
22 Daubert and the experts' testimony was rejected under
23 Daubert. Here we have our experts' testimony being
24 presented in the form of affidavits to the Iowa
25 Supreme Court, and the Iowa Supreme Court saying, "In

1 view of this court's liberal rules on the admission
2 of expert testimony, we cannot say that the
3 plaintiffs' testimony is inadmissible as a matter of
4 law."

5 And, of course, we've had summary judgment
6 motions fully briefed and argued. We've had motions
7 in limine filed and yet to be argued. There's no
8 motion for the exclusion of Dr. Netz' testimony or
9 Professor MacKie-Mason's testimony.

10 So, again, in the Comes I decision, the
11 Iowa Supreme Court has recognized that it's the
12 indirect purchasers that are the real victims here.

13 So to fully understand really the impact of
14 the Comes decision, in light of the arguments raised
15 by Mr. Casper here today in the briefs as to whether
16 or not there is a change of material fact, we need to
17 take a look at a little bit -- we need to look at the
18 class action rule, and then we will also look at the
19 history of the class certification process in this
20 case.

21 First, the Iowa class certification rules
22 since 1980 are no longer based on federal rule. I
23 was very interested to note that virtually every case
24 that Mr. Casper was referring to this morning were
25 federal cases.

1 The intent of this uniform state class
2 action uniform rule was to expand the availability of
3 class actions beyond that permitted under the federal
4 rules. And Mr. Casper is correct, we do agree on
5 something: That Iowa and North Dakota are the only
6 two states, at least to the best of my knowledge,
7 that adopted the uniform rule.

8 Typicality is not required under that
9 uniform rule. Nor is predominance. I've got it here
10 in my notes somewhere and maybe I will find it again,
11 but one of the cases -- one of the Iowa cases that
12 Mr. Casper relied upon was from 1976, Dealers Hobby.
13 And at that point, Dealers Hobby was following, you
14 know, the equivalent of Rule 23. I'm sorry. At the
15 moment, I forget the issue that Mr. Casper cited that
16 case for.

17 Now, under the Iowa class action rules,
18 there are four requirements: The class is so
19 numerous or so constituted that joinder is
20 impracticable. There is no dispute on that. There
21 is at least one common issue of law or fact among
22 class members. A class action will provide a fair
23 and efficient adjudication of the dispute, and the
24 class representatives will fairly and adequately
25 protect the interests of the class.

1 Now, the third item, the fair and efficient
2 adjudication requirement is based upon a
3 consideration of 13 factors set forth in Rule
4 1.263(1). So here we have a list of these 13
5 factors, subparagraphs a through m. These are the
6 operative provisions to determine whether or not a
7 class action is a fair and efficient device. And we
8 will get into it in a minute. What was challenged in
9 the prior certification and what is challenged here,
10 simply put, nine of these factors are unchallenged by
11 Microsoft. And as the Comes Supreme Court said, "No
12 one factor is controlling." So when Mr. Casper was
13 telling you they are failing to prove predominance,
14 impact or predominance of damages over individual --
15 in other words, common issues over individual issues,
16 we will see that the Iowa Supreme Court says, "No,
17 no. We're not" -- "we don't operate like the federal
18 rules." Predominance is just one factor out of 13.

19 So plaintiffs made their motion for class
20 certification back on March 3rd of 2003, and we
21 submitted the affidavit of Professor MacKie-Mason.
22 And just so Your Honor knows, I forgot to explain
23 some of these details because I know them, but Your
24 Honor probably doesn't.

25 Professor MacKie-Mason and Dr. Netz are

1 both principals of a firm called "AppLEcon," which is
2 in Ann Arbor, Michigan. So they've worked together.
3 They've worked together in a number of these class
4 actions against Microsoft.

5 So, for instance, on the original class
6 certification, Professor MacKie-Mason submitted the
7 affidavits, described causation, impact, damages and
8 so forth. And, ultimately, for purposes of the
9 expert reports and expert presentation here in trial,
10 Professor MacKie-Mason will generally be addressing
11 causation, and Dr. Netz will generally be addressing,
12 you know, the impact passed through damages piece.

13 THE COURT: That's MacKie-Mason, not Jackie
14 Mason; right?

15 MR. HAGSTROM: Right.

16 THE COURT: Jackie Mason will speak on the
17 comic element.

18 MR. HAGSTROM: Probably.

19 MR. GREEN: We wish.

20 THE COURT: So then, of course, Microsoft
21 resisted the class certification and through
22 Mr. Casper argued that, "Gee, MacKie-Mason doesn't
23 present real world evidence" and challenged the class
24 certification on that basis. And although you
25 wouldn't guess it from Microsoft's briefing or its

1 argument today, Microsoft challenged the notion that
2 class certification was appropriate for plaintiffs'
3 claim, reduced innovation as a result of Microsoft's
4 conduct, and made that challenge back in 2003 in
5 opposing class certification.

6 And as Microsoft put it, "Only those
7 particular members that actually would have cared
8 about a particular innovation or choice might be
9 harmed by its absence." That was the Microsoft brief
10 submitted July 29, 2003, page 25.

11 And Mr. Casper told you today, that's a
12 new -- that's something new since that class
13 certification. It's not. It was part of the
14 arguments presented to Judge Reis and the Iowa
15 Supreme Court.

16 And Microsoft disputed at length in that
17 class certification process the adequacy of the class
18 representatives, and as I mentioned previously, the
19 length of the class period.

20 So in our reply we went through and point
21 by point rebutted each of Microsoft's arguments and
22 pointed out that many of Microsoft's arguments go to
23 the merits as opposed to whether or not the
24 procedural requirements of the rule have been met.

25 Judge Reis agreed with us. The Iowa

1 Supreme Court agreed with us. And one of the major
2 challenges to -- just like today -- was that
3 Professor MacKie-Mason cannot possibly determine
4 pass-through. It's just too complicated.

5 Then they challenged that his methodologies
6 wouldn't stand up, and they said regression
7 analyses -- they are arguing the same thing about
8 regression analyses back then. But back then
9 Microsoft argued -- excuse me, Microsoft utilized a
10 different expert. That was Professor Jerry Hausman
11 from MIT.

12 And Professor Hausman did not dispute that
13 you can use multiple regression analyses to show
14 pass-through. He just said, "I don't believe that
15 MacKie-Mason's implementation will be correct."

16 But since then, Microsoft, apparently, must
17 have decided they didn't like Professor Hausman's
18 agreement that multiple regression analyses is a
19 standard device, standard economic model to use to
20 develop pass-through, and instead decided they would
21 jettison him and bring in a new expert that disagrees
22 with their old expert.

23 So September 16, 2003, after an extensive
24 hearing on the matter, Judge Reis ruled in
25 plaintiffs' favor. And I don't want to go through

1 the entire opinion, but she carefully considered all
2 of the points raised by Microsoft. And she pointed
3 out, as I just mentioned here today, that Microsoft
4 did not dispute the existence of many common issues.
5 It also did not dispute that many of the factors --
6 that many of the 13 factors either supported class
7 certification or at least were neutral, and Microsoft
8 focused on three or four of those factors.

9 And Judge Reis, indeed, went through all of
10 the factors in 1.263 and found that Microsoft
11 conceded many and many of the factors favored
12 plaintiff, and she also found that none of the
13 factors ran in favor of Microsoft. And most
14 noticeably for purpose of Microsoft's motion today,
15 she refused to embark on an adjudication as to which
16 side would ultimately carry the day on the issue of
17 pass-through because that goes into the merits of the
18 case.

19 Now, Microsoft appealed. The appeal was
20 October 16th of 2003, and, of course, the parties
21 devoted extensive resources to that appeal. And the
22 Iowa Supreme Court received all of the information,
23 heard oral argument, asked questions of both sides,
24 and just 17 months ago in May of 2005, it affirmed
25 Judge Reis's ruling in full.

1 And we discussed some of the issues raised
2 in the briefing in that case in our briefs submitted
3 to Your Honor, so I don't want to go through that.
4 But we have a series of slides that summarize some of
5 the appeal points that Microsoft raised and the Iowa
6 Supreme Court's ruling on those appeal points.

7 Microsoft argued that predominance is
8 required under Iowa law. The plaintiffs expert
9 failed to prove pass-through, that volume licensees
10 are not appropriate class members. We responded that
11 predominance is just one of 13 factors. A class
12 certification is not the time to value the merits,
13 and that the plaintiffs offered sufficient expert
14 testimony regarding pass-through.

15 We also argued that volume licensees are,
16 in fact, members of the class. So the Supreme Court
17 ruled -- again, it rejected Microsoft's argument that
18 predominance is a condition precedent. It said it's
19 only one of 13 factors to be considered.

20 So the district court had highlighted five
21 common questions of law or fact common to all class
22 members. So first is whether Microsoft is a
23 monopolist in the markets for operating systems and
24 applications software and the definition of those
25 markets.

1 Second, whether Microsoft engaged in
2 anticompetitive conduct in order to unlawfully
3 maintain or acquire its monopoly in those markets.

4 Third, whether Microsoft's conduct violated
5 the Iowa Competition Law. All three of those now are
6 common questions of law or fact on liability.

7 Four, whether Microsoft's conduct harmed
8 the proposed class. So that's the impact common
9 question.

10 Five, whether plaintiffs and the putative
11 class members are entitled to damages and the
12 appropriate measure of such damages.

13 The Iowa Supreme Court said, "We believe
14 the court's findings on the first three issues" -- in
15 other words, the common questions of liability
16 alone -- "which Microsoft does not seriously
17 challenge, are sufficient in themselves to justify a
18 finding of predominate issues."

19 So we have those first three issues and
20 that satisfies the predominance factor.

21 There was also the issue of, you know, did
22 plaintiffs' expert fail to prove pass-through? And,
23 of course, that was the fourth common question on
24 impact, and we responded, "This isn't the appropriate
25 time." The Iowa Supreme Court agreed.

1 The court stated, "This court has
2 consistently held that class certification does not
3 involve inquiry into the merits of a case. Microsoft
4 presented contradicting evidence, but it is
5 inappropriate at the certification stage to resolve
6 battles between experts." And it further said, "A
7 district court must ensure that the basis of the
8 expert opinion is not so flawed that it would be
9 inadmissible as a matter of law." And they said, "We
10 cannot say the plaintiffs' testimony is inadmissible
11 as a matter of law."

12 And then, finally, Microsoft argued that
13 volume licensees are not part of the class. We said
14 they were. The Supreme Court ruled, "We find that
15 both the class representatives are members of the
16 class. We have reviewed the remaining issues raised
17 by Microsoft" -- which, of course, include the volume
18 licensing issues -- "and find them to be without
19 merit. We conclude that the district court did not
20 abuse its discretion in certifying the two plaintiff
21 classes. Therefore, we affirm."

22 So there was no mention of typicality by
23 Microsoft before the Iowa Supreme Court, and I think
24 the reason that there was no mention was pretty
25 clear. It's not a part of the rule. You can look at

1 1.261, 1.262 and 1.263 and typicality is not there.

2 And, of course, at the same time they were not
3 arguing typicality to Judge Reis or to the Iowa
4 Supreme Court, they were arguing typicality in the
5 Deiter -- in the Deiter case as part of the MDL and
6 then ultimately to the Fourth Circuit.

7 So Microsoft argued that the trial court
8 abused its discretion, and the Iowa Supreme Court
9 said, "No, it did not."

10 Microsoft's really entire argument on
11 impact and damages was that those were individualized
12 issues as opposed to common issues; and, therefore,
13 those individual issues predominate over the common
14 issues and therefore there can be no class
15 certification. The Iowa Supreme Court rejected that.

16 Now, I find it interesting that Microsoft,
17 neither in its brief or in its presentation here
18 today, went through any of these issues or tried to
19 clarify, dispute, whatsoever; but, of course, it
20 can't dispute. This is what the Iowa Supreme Court
21 said about the classes in this case.

22 And as I mentioned earlier, classes, as
23 defined by Judge Reis and approved by the Iowa
24 Supreme Court, are the same classes today. So by
25 denying this motion for decertification, we have the

1 same identical classes that have previously been
2 approved by Judge Reis and by the Iowa Supreme Court.

3 Now, on the typicality issue, the Iowa
4 Supreme Court didn't say, "Oh, by the way, you've got
5 a typicality issue." It didn't comment. Now, in a
6 moment when we talk about volume licensees in the
7 Hammer decision that Microsoft relies upon, it's not
8 a typicality decision. It's a standing decision.

9 Now, under the legal standard for
10 decertification, I don't think I heard any standard
11 set forth by Mr. Casper. We heard, you know, a lot
12 of different allegations, but the bottom line is that
13 there has to be a material change in the law and/or
14 the facts and Microsoft doesn't dispute that it bears
15 this burden. It has failed to demonstrate any
16 material changes in the circumstances in the facts
17 since the 2003 class certification.

18 So we ask: Has there been anything changed
19 legally? The law is the same. The rule is the same.
20 Factually; you heard Mr. Casper say, "Well, we
21 promise to prove pass-through, but that is not
22 fulfilled." They argue that we have new claims, and
23 they argue that we have new evidence regarding volume
24 licensees.

25 Well, as we already mentioned, none of this

1 is new, as we will see shortly. And as of the time
2 of the class certification, as I mentioned,
3 Professor MacKie-Mason and Dr. Netz had already done
4 numerous pass-through studies in other states and, in
5 fact, that was one of the things that Microsoft
6 challenged in the Comes decision.

7 At page 224 the Court said, "Microsoft
8 challenges this conclusion," and the conclusion had
9 to do with whether there was classwide impact on all
10 the class members. "Microsoft challenges this
11 conclusion largely on the ground that professor's
12 studies were conducted in states other than Iowa."
13 So just stopping right there, the Iowa Supreme Court
14 understood that these same types of pass-through
15 studies had already been done. Judge Reis recognized
16 that. What Microsoft was arguing was, "Well, yeah,
17 we understand that these are pass-through studies and
18 they all show pass-through of at least 100 percent,
19 but they aren't good enough."

20 The Iowa Supreme Court went on to say, "We
21 fail to see, however, how the geographic residence of
22 the affected purchasers has any bearing on the
23 validity of the studies, and Microsoft shows us no
24 basis for concluding otherwise." So we have these
25 identical arguments being made to the Iowa Supreme

1 Court, and they were rejected.

2 Now, one thing about the change in the law,
3 Microsoft cited to a Texas case, Wood v. Victoria
4 Bank & Trust, in their brief and they said, "Well,
5 gee, there was this one case out there where
6 subsequently a case was decertified when the prior
7 decision had gone up to an appellate court on class
8 certification and was approved."

9 Our position is that because this case has
10 been to the Iowa Supreme Court and we have a ruling
11 on class certification, that it's essentially the law
12 of the case, absent very compelling circumstances of
13 a factual change or an illegal change.

14 Well, in this Texas case that Microsoft
15 cited, the standard for class certification at the
16 time was certify now, ask questions later. So, in
17 other words, you really didn't have to do much. You
18 didn't put in any affidavits of experts, anything
19 like that.

20 But by the time the decertification motion
21 came around, the Texas Supreme Court in a separate
22 case had said, "We're no longer going to follow this
23 "certify now ask questions later" process and there
24 was some problems in that particular case factually
25 and the case was decertified.

1 But that's not the situation we have here.

2 We have the Iowa Supreme Court addressing every
3 single one of the arguments that Microsoft has
4 raised.

5 Now, Microsoft also mentions the Vos case.

6 That was a case in which a class was decertified, and
7 in that particular case the -- and that was what is
8 called a life insurance vanishing premium case. In
9 other words, it's where consumers buy a life
10 insurance policy and they are told after x number of
11 years, your dividends will exceed your premium and,
12 therefore, after that x number of years, you will no
13 longer have to be paying a premium. So that's why
14 it's called a "vanishing premium" case.

15 That case was certified, but then after
16 discovery it was determined that the sales practices
17 at issue, in other words, the foundation for the
18 liability showed that the practices were not uniform.
19 The conduct wasn't uniform with regard to the life
20 insurance policyholders. And so as a result -- and
21 there was some other differences too that made it
22 impossible to prove liability on a classwide basis.

23 So as a result then, the trial court
24 decertified the case, and the Iowa Supreme Court
25 found that it was not an abuse of discretion because

1 there was not even common issues of liability, unlike
2 here where we had five questions of common law or
3 fact that we listed. And the Iowa Supreme Court said
4 the first three common questions of liability are
5 sufficient in and of themselves.

6 So Microsoft tries to fit the square peg
7 into the round hole here and try to use Vos as a
8 means to get decertification. Microsoft argues that
9 plaintiffs and their experts broke their promises,
10 that the claims are vastly expanded, that there is
11 all sorts of new evidence. But as I mentioned, this
12 case is not like Vos at all because here we do have
13 at a minimum the common issues on liability, and we
14 also have common issues on impact of damages.

15 Now, back to these four requirements. We
16 really only focus on a couple here. As I mentioned,
17 Microsoft does not contest the first two and, in
18 fact, it didn't contest the first two in the prior
19 certification proceeding.

20 So whether there is a fair and efficient
21 adjudication of the dispute, again, we look to the 13
22 factors. Here Microsoft raises on decertification,
23 e, f, g and h, which are the same four factors, Your
24 Honor, that it raised previously. So it argued
25 there's no predominance previously. You heard

1 Mr. Casper argue today common issues do not
2 predominate. But again, he's arguing that not as to
3 liability, but as to impact and damages.

4 Other means of adjudication are impractical
5 or inefficient. Class action offers the most
6 appropriate means of adjudication. Absent class
7 members have a substantial interest in individually
8 controlling the prosecution or defense of separate
9 actions. That last one is the adequacy requirement.
10 You know, there's no typicality requirement, only an
11 adequacy requirement, and that, again, was addressed
12 by the Iowa Supreme Court.

13 So what this means is we've got nine
14 uncontested factors. And just as Judge Peterson
15 recognized in the Gordon case, a class certification
16 standard must be interpreted in a way that gives
17 effect to the legislature's decision to allow
18 indirect purchasers standing. So again, it's the
19 indirect purchaser who is most frequently injured.

20 And, of course, if we were to decertify
21 this case, these real victims would not be
22 compensated and Microsoft would retain its ill-gotten
23 gains. That, Your Honor, is not the appropriate
24 process.

25 So I want to turn to the concept of pass-

1 through, and let me just mention the standards of
2 proof. And now I'm go to stray a little bit here
3 from the elements of the class action rule because I
4 want to point out something in terms of the elements
5 of a cause of an action, so I want to make sure that
6 we're clear about this.

7 I've cited a couple of federal cases here,
8 but we also have several Iowa Supreme Court decisions
9 that hold the same way. In an antitrust case you're
10 dealing with, really, an actual world as compared to
11 what is called a "but for" world, or a "competitive"
12 world, for lack of a better term.

13 And what the cases hold is that you prove
14 impact by a preponderance of evidence, but proof of
15 quantification or proof of the amount of loss can
16 border on the speculative. I think Roxanne Conlin
17 discussed some of these Iowa decisions with Your
18 Honor that state the same thing. I think she cited
19 to the Orkin decision. I, unfortunately, don't have
20 the case cite with me on that.

21 And as the Eighth Circuit said, "This
22 lesser standard for purposes of quantification of
23 damages derives from the principle that a wrongdoer
24 should not profit from the harm occasioned by its
25 act." And that's from the National Farmers'

1 Organization v. AMPI case.

2 So we have three common issues. These
3 alone are sufficient for purposes of class
4 certification. And Microsoft raises the issue about
5 proof of impact and proof of damages with regard to
6 items 4 and 5. But again, proof of those elements is
7 a matter of the battle of the experts, which the Iowa
8 Supreme Court said you do not get into in the
9 certification or, for that matter, decertification
10 process.

11 Let's take a look at what our damages
12 methodologies are. But just let me comment here on
13 the overall issue of pass-through.

14 In the 2003 affidavit, Professor
15 MacKie-Mason said, "We're going to use three
16 benchmark methods to measure the amount of the
17 overcharge: The profit margin, the rate of return
18 and the price premium method."

19 In Dr. Netz' June 2, 2006 expert report,
20 she uses the three same benchmark methods.

21 With regard to this next slide, there were
22 five sources of evidence cited by Professor
23 MacKie-Mason on the pass-through issue: Economic
24 theory. And, Your Honor, I sort of put that economic
25 theory in very lay terms this morning when I said I

1 was going to tell the jury that pass-through is
2 really the simplest thing it's going to have to
3 understand in this case. That, you know, businesses
4 pass on their costs. So economic theory is textbook
5 analysis that businesses pass on their costs.

6 I also mentioned that there's external
7 Microsoft studies. There's some studies by the
8 Viewpoint Group that we cite in our brief. Microsoft
9 also did internal studies. We said we would be doing
10 regression analyses, and then, additionally,
11 Microsoft's own experts admit as to pass-through.

12 Now, we used the same five sources of
13 evidence for purposes -- we intend to use the same
14 five sources of evidence for purposes of trial. So
15 again, nothing has changed here.

16 As I mentioned, the experts, one of
17 Microsoft's experts, Richard Schmalanese, who
18 testified in the government case, was their chief
19 economic expert. He stated that, "OEMs pass the
20 price of the operating system through two consumers
21 as part of the overall price of the computer." I
22 mean, what Dean Schmalanese was saying is what
23 well-accepted economic theory says.

24 In addition, in Minnesota, the Minnesota
25 case, the California case, Microsoft used two

1 experts, two economic experts to calculate damages to
2 the class.

3 In Minnesota the two used some slightly
4 different methodologies, and came up with slightly
5 different numbers. Both of them said, "Here is what
6 our view is that the class was damaged by this
7 amount."

8 But when they were asked at deposition,
9 "Well, so you're assuming pass-through," and, of
10 course, they were.

11 Now, Microsoft suggests in its brief,
12 "Well, of course, that's nonsense. They weren't
13 addressing the issue of pass-through." But it would
14 have been pretty obvious to the jury that if
15 Microsoft is presenting two experts who are
16 presenting damage numbers for the class, that they,
17 in fact, are assuming that these overcharges to
18 direct purchasers were passed through by those direct
19 purchasers to class members.

20 Now, as Judge Peterson noted in the Gordon
21 case, "Plaintiffs have produced a report of
22 economists who opined that, on average, at least 100
23 percent of a Microsoft monopoly overcharge is
24 ultimately passed on to consumers. They rely on five
25 sources of evidence for this conclusion." It's the

1 same five sources of evidence that Professor MacKie-
2 Mason just -- that we just saw he used in 2003. It's
3 the same five sources of evidence that we intend to
4 present to the jury here.

5 Judge Peterson writes, "First, economic
6 theory predicts that when distribution markets are
7 competitive, a cost increase to distributors will
8 cause a price increase of the same amount to
9 consumers. The experts find the distribution markets
10 involved here to be competitive. They also reviewed
11 three sources of existing evidence which they believe
12 corroborates the theoretical prediction -- Microsoft
13 internal documents, surveys conducted by Microsoft
14 consultants, and the testimony of Microsoft experts.
15 Finally, plaintiffs' experts conducted regression
16 analyses with a relatively small percentage of the
17 transactions at issue here and found that the actual
18 data support a pass-through rate of at least 100
19 percent."

20 Now, let me talk a minute about the
21 distribution markets. There are two channels for
22 distribution of the Microsoft products here. One is
23 the OEM channel.

24 The OEM channel, for instance, includes
25 companies like Dell, Hewlett-Packard. These are the

1 original equipment manufacturers where software is
2 preinstalled.

3 The other channel is called the "finished
4 goods" channel, and that channel has retail sales.
5 It basically has shrink wrapped sales where you go to
6 Best Buy or Circuit City and buy a piece of software
7 off the shelf. And it includes the volume licensee.
8 And what Judge Peterson found here was that these
9 channels are competitive.

10 And, Your Honor, it's just common sense
11 that when you have competition between similarly
12 situated vendors, they are competing for sales. And
13 what happens when you have competition in this
14 distribution market, in other words, the distribution
15 channels, the competition means that margins are
16 tight. And when you have tight margins, it means
17 when you have a "cross the market" price, for
18 instance, with Microsoft software, when you have
19 everybody getting charged for Microsoft software,
20 what is going to happen? Those costs are going to be
21 passed on to the consumer because, number one, the
22 margins are so slim they have to pass on the cost to
23 stay in business; and, number two, if they try to
24 create very large margins, they are going to lose
25 sales to their competitors because there is such a

1 high degree of competition in these channels.

2 Now, with these five forms of evidence,
3 Judge Peterson recognized that plaintiffs have
4 presented evidence on the impact issue. He
5 recognized that that evidence was sufficient to go to
6 the jury on the issue of impact.

7 So there is nothing new about the
8 methodologies proposed by plaintiffs' experts.
9 Professor Netz and MacKie-Mason proposed the same
10 methodologies of proving the overcharge, the
11 classwide impact and the damages in this case as they
12 did in state courts in Arizona, California, New
13 Mexico, Minnesota and Wisconsin. And every one of
14 those courts accepted those methodologies for
15 certification and/or decertification purposes,
16 although Minnesota was the only court to actually
17 rule on decertification.

18 And, of course, Judge Reis and the Iowa
19 Supreme Court accepted these methodologies as
20 sufficient for purposes of impact and damages.

21 Now, faced with the undeniable fact that
22 these methodologies are identical and have not
23 changed since 2003, Microsoft says, "Well, there's
24 new evidence from Iowa resellers." Its own experts
25 supposedly, you know, go through and suggest that

1 there is some differences based upon this new
2 evidence.

3 Now, back in 2003, Microsoft said, "Well,
4 this pass-through evidence isn't good enough." They
5 said, "These are nationwide, not in Iowa firms. Fact
6 discovery in this case will not give plaintiffs any
7 better data for analyzing OEM pricing pass-through
8 and possible passes through than they already have."
9 So, in other words, that wasn't good enough, and they
10 can't do any better. So, therefore, they are going
11 to be unsuccessful, is what Microsoft was saying.

12 You can see today in their present briefing
13 there is also now a vastly expanded factual record
14 that includes sales data and testimony from Iowa
15 resellers, and they say it's insufficient. Same
16 arguments.

17 And as I mentioned earlier, the Iowa
18 Supreme court addressed this very issue and said, "We
19 fail to see how any geographic difference in where
20 you get the data in terms of resellers makes any
21 difference. They said it doesn't.

22 Now, there's no question that the evidence
23 Microsoft cites now is of the same type that it cited
24 three years ago, and here is a comparison of what
25 Microsoft argued in 2003 as opposed to now.

1 In 2003 it said the pricing of PCs to
2 end-users, end-user/consumer varies considerably.
3 Now, it says the markups on PCs are not fixed or
4 constant. It's just rewording the same argument.

5 They also argued that intermediaries employ
6 different selling and pricing strategies. Currently,
7 they argue resellers use various pricing strategies.
8 You heard Mr. Casper say, "Well, you see that -- you
9 know, "you can go to one store and might see a
10 product at one price and go to another store and see
11 a product at a slightly different price." But that
12 tells you absolutely nothing about the pass on of the
13 overcharge, the pass on of the costs. It tells you
14 nothing.

15 Microsoft also argued that focal point
16 pricing or other marketing techniques is widespread
17 at the retail level. They said not only the focal
18 point pricing, but loss leaders, those kinds of
19 things, argued all those types of arguments back in
20 2003. They make the same arguments today. And let
21 me just make a comment on this particular aspect.

22 As our experts point out, what we're
23 looking at here for purposes of this case is what
24 would the price be in the "but for" world? So we
25 know what the prices are for Microsoft's products in

1 the actual world, but if they are less in the "but
2 for" world, as we contend they would be, all of the
3 same things are going on in the "but for" world. In
4 other words, these retailers, if they are going to
5 have loss leaders, they are still going to do it.
6 They are still going to engage in those same types of
7 marketing practices. They are still going to have
8 focal point pricing. It's just that if they happen
9 to do it with regard to a particular Microsoft
10 product, the overall price level is going to be lower
11 because of the absence of an overcharge.

12 So these same types of arguments were made
13 to the Iowa Supreme Court. It determined it did not
14 defeat class decertification.

15 Microsoft also argued in 2003 resellers in
16 these markets often, in fact, do not pass on
17 component cost increases to their customers.
18 Currently, multiple Iowa resellers have testified
19 that they do not always pass on cost changes.

20 So when we look at this so-called "new
21 evidence" side by side, it's the same arguments, same
22 arguments that were rejected by Judge Reis, same
23 arguments that were rejected by the Iowa Supreme
24 Court.

25 As I mentioned, the Iowa Supreme Court

1 says, "You do not engage in a battle of the experts."
2 It says, "Microsoft presented contradicting evidence,
3 but it is inappropriate at the certification stage to
4 resolve battles between experts. A district court
5 must ensure that the basis of the expert opinion is
6 not so flawed that it would be inadmissible as a
7 matter of law." They concluded our experts'
8 testimony was not inadmissible as a matter of law.

9 So in addition to this, these same
10 methodologies by Professor Netz and Mackie-Mason were
11 accepted by state courts in Arizona, California,
12 Minnesota, New Mexico, New York and Wisconsin.

13 Now, remember, I told you that
14 Professor Hausman was there, was Microsoft's expert
15 on these issues. Now they've switched to
16 Professor Paul.

17 So our experts' methodologies have been
18 accepted in all of these states. Dr. Paul's methods
19 and arguments were rejected in New York. That's the
20 only state where she's presented affidavits. That
21 was the first state after Microsoft jettisoned
22 Professor Hausman in favor of Dr. Paul.

23 And that one state, the New York state
24 court rejected Professor Paul's approach.

25 Now, with regard to the attacks on the

1 issue of impact, as I mentioned, Dr. Netz uses the
2 same benchmarks for overcharge as were listed for
3 Judge Reis and the Iowa Supreme Court. Profit margin
4 method, rate of return method, and price premium
5 method.

6 Now, what Dr. Netz says in her expert
7 report and in her affidavit in resistance to the
8 decertification is that pass-through -- her studies
9 on pass-through and the other evidence relate to
10 profit margin and rate of return.

11 Now, pass-through is not needed for
12 purposes of the price premium method.

13 As Dr. Netz concludes that the price
14 premium methods -- I will just explain briefly. You
15 take the price premium at retail level of Microsoft
16 products at issue and compare that premium to the
17 premium that Microsoft gets on its products where it
18 faces competition, and the difference is one method
19 then of measuring an overcharge. Since this is all
20 done at the retail or end-user level, the last
21 transaction in the chain of distribution,
22 pass-through is not part of that calculation.

23 So even if Microsoft was right, which they
24 are not, with regard -- that we are just so off base
25 with pass-through that we just can't possibly use

1 profit margin and rate of return, price premium

2 method does not use pass-through.

3 And I was just reminded that Microsoft is

4 not challenging the price premium method in their

5 brief.

6 Now, Microsoft showed you some charts and

7 they talked about the issue of overcharge, whether a

8 cost increase gets passed through in terms of retail

9 prices.

10 In fact, Microsoft even concludes that

11 there is no relationship between the two. So

12 Microsoft further concludes that since an overcharge

13 was a cost, this necessarily means there was no

14 relationship between the overcharge and retail

15 prices.

16 So Microsoft says that retail prices were

17 not affected by the overcharge and end users were not

18 injured. That's sort of the theory they follow.

19 And you saw this chart, one very similar to

20 it, presented to you by Mr. Casper. This comes out

21 of Dr. Paul's affidavit.

22 And I think this is part of its reply

23 brief. It shows prices for this OEM at a stable

24 amount, and it purports to show costs differing over

25 time. And Microsoft says, "Look, obviously there's

1 no relationship between cost and price, which they
2 then conclude means costs were not passed on so,
3 therefore, no overcharge was passed on."

4 There's many, many problems with this
5 explanation. First of all, the many problems result
6 from using essentially just raw data points instead
7 of multiple regression analysis.

8 For one thing, you can see that -- assuming
9 this chart is accurate, the difference between the
10 line is the profit. So we know as a matter of fact
11 that Gateway received more back in terms of price
12 than it cost for the computer. So it was always
13 making a profit.

14 So we know that somebody is paying --
15 assuming there is Microsoft software in these costs,
16 we know that any overcharge within those costs is
17 ultimately being recovered by the price. So whoever
18 is paying the price is also, therefore, paying the
19 overcharge.

20 So this chart also includes total costs,
21 not simply the cost of Microsoft products, but we
22 don't know what all those costs are included or
23 excluded.

24 Now, as I mentioned, this is not a multiple
25 regression analyses, so we don't have sufficient data

1 to analyze these data points. And, indeed, Microsoft
2 cited in its brief a couple of cases, the Methionine
3 case, which was a federal court decision, I think,
4 out in California, and the Execu-Tech case out of a
5 state court in Florida.

6 Both of those cases rejected the
7 plaintiffs' expert's analysis because they did a
8 simple regression. They didn't do a multiple
9 regression. Yet dispute the cases that it cites,
10 what it's doing here is a simple regression.

11 Dr. Netz, on the other hand, did a multiple
12 regression analysis. Now, Microsoft is simply
13 assuming that all of the overcharge is in the form of
14 cost increases, and the overcharge itself somehow
15 accounts for short-term costs, but this is simply not
16 the case as Dr. Netz has demonstrated in her expert
17 report.

18 Now, although Microsoft makes this
19 assumption, Dr. Paul admitted in her deposition that
20 she cannot identify which part of the cost of a
21 Microsoft product was the overcharge. So while she
22 puts together charts and so forth and makes general
23 statements, she really doesn't have the foundation to
24 make those statements.

25 So she says pass-through involves the

1 response to a cost change. I don't know what the
2 resellers' behavior would have been if there was a
3 cost change. This just gives me information on the
4 overall price and cost levels. So the example is if
5 you have these, just these raw data points, that's
6 insufficient information to draw a conclusion as to
7 what happens with regard to pass on of the
8 overcharge.

9 Now, so we don't see this OEM selling the
10 product for less than its cost. We don't see this
11 OEM giving away Microsoft software. So what we can
12 conclude is that since Gateway got all of its cost
13 back in the selling price necessarily means it got
14 paid all of the overcharge it paid to Microsoft and
15 passed that on.

16 Now, interestingly, this OEM recognizes the
17 Microsoft tax. This is a document from this
18 particular OEM, and in its pricing decision it
19 recognizes there's a Microsoft tax on every computer
20 it sells. And, of course, it's going to recover that
21 Microsoft tax, and it did just looking at the raw
22 data in that prior chart.

23 We can think of the overcharge -- and I
24 know Mr. Casper will disagree with me because we've
25 had this discussion in previous class certification

1 arguments -- but you can think of this Microsoft tax
2 as, in fact, a tax, for instance, on gasoline. I
3 mean, Your Honor is aware there's a state gasoline
4 tax here in Iowa, and it's at 21 cents. So if we
5 have the retail gasoline price -- it's going to be
6 moving all over as we've seen. Now we've got this
7 squiggly line here along the top of the page
8 indicating the price. That's the retail price that
9 when you go to a gasoline station, that's the kind of
10 price you're paying. And, of course, we're up at
11 three bucks or so a gallon and now, of course, in the
12 last couple of months the price has dropped
13 dramatically.

14 Well, even with whatever is going on here
15 with regard to the retail price, a part of that --
16 you've got a segment in here of 21 cents. That's the
17 state gasoline tax.

18 So Microsoft's argument is that, "Well,
19 because you've got these changes in costs up here,
20 would necessarily mean these gasoline retailers are
21 sometimes eating this tax." They don't. It's passed
22 through on the cost. You have price levels changing.
23 Just because you can go to Best Buy at one shopping
24 mall and you have a computer at \$2000, and you go to
25 Circuit City at another shopping mall or some other

1 store and that same computer might be \$1900, it
2 doesn't mean that all of a sudden the Microsoft
3 overcharge has disappeared.

4 So with this 21 cents, the point here is
5 that if the price of gasoline dropped by a buck, for
6 instance, and followed the same pattern, you've still
7 got this amount in here. But what we're talking
8 about for purposes of this case is if you take the
9 price of -- the retail price, for instance, of
10 Microsoft software, and as I mentioned, we've got a
11 60 percent overcharge, according to Dr. Netz, so if
12 on -- if in the "actual" world we're at \$100 for the
13 retail price of a piece of software, you've got \$60
14 in overcharge.

15 What is going to happen in the "but for"
16 world is the \$100 drops down to \$40. And Dr. Netz,
17 in her affidavit, goes through an analysis like this,
18 and she talks about things like focal point pricing
19 or if the retailer, for instance, wants to actually
20 sell this below cost, say they want to sell it at
21 \$95. So in the "actual" world, it shows that it's \$5
22 below its actual cost. But in the "but for" world,
23 if the retailer has made the marketing decision that
24 it's going to use this as a loss leader or it's going
25 to use this to attract customers for purposes of,

1 "Hey, come on in. Look, we're running this special
2 today. You can get product X at only \$1," the
3 purpose of it is marketing, to get traffic in.

4 So that same marketing technique will be
5 used in the "but for" world. So instead of \$40, it's
6 at 35. The difference is still the \$60. Dr. Netz go
7 through this analysis in her affidavit.

8 Now, Microsoft disagrees with this
9 analysis, but this is what happens in the "real"
10 world, and this is what would happen in a "but for"
11 world.

12 Now, Microsoft also attacks the use of
13 multiple regression analysis; and in the briefs,
14 Microsoft asserts that you cannot use multiple
15 regression analysis to prove impact.

16 Microsoft is simply incorrect.

17 Your Honor, if I could hand up.

18 THE COURT: Sure. Thank you.

19 MR. HAGSTROM: We just did a quick sampling
20 of some cases. Multiple regression analysis is
21 generally accepted by the courts. It's accepted in
22 the Manual on Complex Litigation. These cases talk
23 about and approve the use of multiple regression
24 analysis. The Methionine case that Microsoft cites
25 where the expert's testimony was kicked out under

1 Daubert because they didn't use multiple regression
2 rather than a single regression, the court said, "You
3 should have been using multiple regression for
4 purposes of impact."

5 These cases say that and that's what our
6 experts use. And, for instance, in the Daniel v.
7 American Board of Emergency Medicine, "As discussed,
8 the multiple regression analysis and Dr. Carlton's
9 impeccable credentials as a nationally recognized
10 economic expert provide an adequate basis to account
11 for any relevant variables in the particular
12 circumstances of individual class members in seeking
13 to establish a classwide impact caused by the charged
14 violation in this case."

15 Now, Microsoft, as I mentioned, cited the
16 Methionine case, cited several other cases. In their
17 reply they say, "It's well-settled that an antitrust
18 plaintiff must prove the injury elements of its claim
19 with some certainty." It's interesting we cite the
20 same Story Parchment case but different sentences in
21 the same paragraph, as I already showed you in the
22 earlier slides for quantification, as long as the
23 quantification is not speculative, it suffices. The
24 injury element most certainly cannot be proven on
25 average as plaintiffs admit they are proposing to do

1 here.

2 So Microsoft is saying "You're using
3 multiple regression analysis, which, by definition,
4 are averages, therefore, your proof fails." That's
5 what Microsoft is arguing.

6 True, multiple regression analyses, as I
7 mentioned earlier, are a form of average, but it's
8 not a simple average like I mentioned like adding two
9 plus six the average is four. So here they are
10 saying as Methionine, Earnest and Execu-Tech,
11 plaintiffs are using their experts proposed
12 regression analyses not just to estimate but also to
13 as their proposed classwide proof of impact, they are
14 saying you just can't do that. Well, with the
15 handout I just gave you, those cases plus the
16 American Board of Emergency Medical, that we just saw
17 the quote, those cases say you can, in fact, use
18 multiple regression analyses to prove impact.

19 And I should mention, that it's not only
20 proving impact for purpose of antitrust cases.
21 Multiple regression analyses are used, for instance,
22 to show impact in discrimination cases and other
23 types of cases. It's a well-accepted methodology.

24 Now, as I mentioned in Methionine, the
25 experts' opinions tested under Daubert. They were

1 rejected under Daubert. Iowa doesn't have Daubert,
2 plus we've got the Iowa Supreme Court that has
3 already looked at the methodologies and said, "These
4 fit within Iowa's liberal rules of expert
5 admissibility."

6 And just as I mentioned previously when
7 Microsoft -- Mr. Casper mentioned the Heerwagen case,
8 that also was a court rejecting an expert's testimony
9 under Daubert. So it has no application here.

10 And I just have to make a side comment on
11 that. As a fundamental matter of juris prudence,
12 just because the Iowa Supreme Court cited the
13 Visa/MasterCard decision of the Second Circuit for
14 purposes of a proposition that the Iowa Supreme Court
15 adopted at the time of the Comes decision, doesn't
16 mean that the Iowa Supreme Court adopts every
17 subsequent decision of the Second Circuit. I mean,
18 it cites a proposition, and it's accepting that
19 proposition. It's not necessarily accepting anything
20 else the Second Circuit ever says.

21 Now, with regard to the multiple regression
22 analyses, Microsoft would have you think that
23 Professor MacKie-Mason made some promises, and I
24 think Mr. Casper said that those promises were not
25 kept.

1 Well, this is a summary exhibit that is in
2 Dr. Netz's expert report, and this identifies over 40
3 multiple regression analyses. You see on the
4 left-hand column the "OEM Channel," and you'll see in
5 the right-hand column the "Finished Goods Channel,"
6 which has as part of it the "retail segment" and the
7 "corporate segment" or the volume -- the "volume
8 segment."

9 In each of these studies, the regression
10 analyses, the multiple regression analyses showed
11 pass-through in excess of 100 percent, and the
12 overall weighted average of all pass-through studies
13 conducted by Dr. Netz and ApplEcon was 114 percent.

14 So we have Professor Paul, Microsoft's
15 expert challenging Dr. Netz' analyses by making
16 Microsoft's standard argument that it makes here,
17 it's made numerous times previously, about varying
18 retail prices. And as we saw on the drawing, varying
19 retail prices tell you nothing. They tell you
20 nothing about pass on of the overcharge.

21 Again, even if there was only a one percent
22 pass-through, that shows impact. So even if one
23 percent, a tenth of a percent, we can go to an
24 extreme, of the overcharge is passed through,
25 somebody is injured. The end user is injury,

1 satisfying the impact prong of the three elements of
2 the cause of action.

3 With regard to the multiple regression
4 analyses, we had a "give and take." I had a "give
5 and take" with Judge Peterson about what multiple
6 regression analyses is compared to a simple
7 regression or simple averages.

8 And Judge Peterson understood that with
9 multiple regression, you can -- you can account for
10 changing variables. And once he understood that,
11 Microsoft -- Mr. Casper had presented some of
12 these -- I can't recall if they were identical
13 charts, but very similar, you know, a price line and
14 cost line. And once Judge Peterson understood that,
15 that that was at best a simple regression, he
16 understood that multiple regression will take into
17 account the changing variables.

18 And so you might have different components.
19 There might be different competition. There might be
20 shipping included, might be shipping excluded. I
21 mean, these are different factors that you need to
22 take into account that just appear raw data is not
23 going to tell you.

24 So just to demonstrate regression, let's
25 just take an example here. Let's assume we've got a

1 line, you know, a bunch of data showing the age of
2 the person graphed against the height of a person.
3 So as you might expect, this person gets older, they
4 grow taller. So a one-year old is going to be
5 shorter than a 19-year old. So, here, we can graph
6 the relationship of these data points.

7 Now, we want to make sure there's some
8 correlation since we occasionally see exceptions in
9 the data such as a one-year old who might be taller
10 than a two-year old. And so to determine if there is
11 relationship between height and age with regression,
12 we can use a simple linear regression model. We
13 start by charting the height and ages of young adults
14 and children in our sample. Then if we regress
15 height on age using the data we plotted, we get this
16 line which predicts how much height increases with
17 age for the particular age group. So what we see
18 from a simple regression, we can conclude that
19 generally height increases with age.

20 Now, let's take a look at -- what if we
21 wanted to look at just 15- and 16-year-olds, and so
22 we want to just narrow -- we want to slice and dice
23 this data that we've got down to just a couple of
24 data points. So here we see in this slide there's a
25 couple of data points for 15- and 16-year-olds.

1 Now, suppose we try to stratify our
2 analysis to determine variances in the age and height
3 correlation among people with different hair colors.
4 So we slice and dice population, and for red heads we
5 only have two people in our sample: A 15-year-old
6 and a 16-year-old. So we plot that data.

7 Now, as it so happens in our data, our
8 15-year-old red head was taller than our 16-year-old
9 red head. But we plot a linear relationship between
10 the two, and if you extend that out, regressing on
11 height versus age, we get a line that implies the
12 existence of close to a 100-inch-tall one-year-old.

13 So when you slice and dice the data, you
14 can get very unusual results, and when you get these
15 types of unusual results, it's telling you something.
16 It's telling you your result is incorrect, number
17 one. Number two, you can usually determine that
18 that's a result of faulty data, or your data does not
19 have sufficient variation in it, or you don't have
20 sufficient data altogether.

21 So while we would say the stratification
22 was over done at least in absurd results, Professor
23 Paul would say, no, it's not an absurd result at all.
24 It means that height has no direct relationship with
25 age for red heads, just like she says the cost has no

1 direct relationship with price.

2 But that might be what we should expect
3 from somebody who says that for every dollar increase
4 in costs, based upon her regression analysis, Best
5 Buy's price on the product she regressed drops by
6 \$3.50. So based upon her studies and her slicing and
7 dicing of data, if Best Buy had a dollar increase in
8 cost of product, it drops its price by \$3.50. Now, I
9 guarantee you, Best Buy is a good corporate citizen
10 up in Minnesota, very successful, and I can tell you
11 that they do not engage in that type of pricing.

12 So let's take a look at one of the examples
13 that Professor Paul uses in her criticism of
14 Dr. Netz price cost relationship as Dr. Netz has
15 determined from multiple regression analyses.

16 And I think Mr. Casper had something very
17 similar to this up in one of his charts, comparing
18 Office 2000 and Windows XP. And this is a chart
19 right from Professor Paul.

20 So this depicts her view of a zero cost
21 price relationship for Windows XP and for Office
22 2000. So with this next slide, we, again, show the
23 logical extension of what her assumption is.

24 So with a zero price cost relationship for
25 Office 2000 implies the prices don't change even when

1 costs may decrease by as much as 100 bucks. So
2 whereas under her data point she had a \$200 price
3 point with a cost point of approximately \$170, \$180,
4 when the cost drops to \$70, under her analysis the
5 price remains stable at \$200. Number one, that is
6 not going to happen in the real world. There's
7 competition out there. Competition prevents that
8 from happening.

9 Similarly, you look at Windows XP and the
10 linear extension of what she says is the zero price
11 cost relationship implies that prices don't change
12 even when the cost increased by 100 bucks. So you've
13 got -- for Windows XP, if you've got a cost of
14 approximately \$90, even when that cost goes up to
15 \$190, the price doesn't change. So meaning that
16 whoever is reselling that product is losing a
17 substantial amount of money by even completing the
18 sale.

19 So let's apply these concepts to the actual
20 data back to this OEM slide. So, again, Microsoft
21 and Professor Paul look at this chart and conclude
22 that costs and therefore overcharges are not being
23 passed on. But if we apply multiple regression
24 analysis to the chart, we will get a different and
25 more accurate result.

1 But first what Dr. Netz did with this data,
2 she went through to identify the component cost
3 fluctuations. And if the quality of the machine
4 decreased while costs were increasing, this would
5 mean the quality adjusted price changed even as the
6 actual price stayed the same.

7 So in this example, Dr. Netz' investigation
8 revealed that in March of '99 Gateway upgraded the
9 hard drive to this computer from an 3.2 gigabytes to
10 4.3 gigabytes. In April Gateway upgraded the
11 motherboard from a Tabor to a Tabor 2. In May
12 Gateway upgraded the DVD from DVD3 to a DVD 6x and
13 downgraded from a Tabor 2 motherboard to a Tabor
14 motherboard. And there's several other changes going
15 on during this course of time which I will get into.

16 So while costs are changing, the quality
17 characteristics are also changing. Even as the price
18 stayed the same, the multiple regression analysis is
19 needed to account for these changes.

20 So Dr. Netz did do multiple regression
21 analysis on the Gateway data, and as this chart
22 indicates, there was 104 percent pass-through. So
23 looking at raw data in and of itself tells you very
24 little, if nothing. Judge Peterson recognized that
25 when presented with a virtually identical type of

1 scenario by Microsoft.

2 So as he wrote in his opinion, "Even if
3 specific distributors sometimes absorb specific cost
4 increases, there is no evidence before the court that
5 any distributor absorbed all the cost increases
6 making up the full monopoly overcharge." So there he
7 was even giving Microsoft the benefit of the doubt
8 that in some instances when you're dealing with what
9 I've called the chatter at the retail pricing level,
10 if that's indicative of some costs not being fully
11 passed through, it still doesn't mean the overcharge
12 is not.

13 THE COURT: We're going to take a recess at
14 this time. Fifteen minutes.

15 Sorry to interrupt, Mr. Hagstrom, but my
16 court reporter gets a break.

17 MR. HAGSTROM: That's great.

18 (A short recess was taken.)

19 THE COURT: Mr. Hagstrom.

20 MR. HAGSTROM: In Microsoft's reply brief,
21 it argued that what Dr. Netz does is measure market
22 rates rather than pass-through rates. In response,
23 Dr. Netz in her affidavit, her responsive affidavit
24 to the motion for decertification, went back and did
25 a study on the data in which -- for the Iowa

1 companies for which she had done a pass-through
2 study. And she went through and calculated the
3 markup rate and calculated the pass-through rate to
4 demonstrate that what she was measuring with regard
5 to pass-through was, in fact, pass-through. And when
6 you measure markup, it's different. Markup is a very
7 simple formula. In other words, it's just what's the
8 amount of pricing on top of your costs. For
9 instance, a ten percent margin or markup on a \$100
10 product, of course, is \$10.

11 So that's what this chart does. And so
12 just to be clear, she has measured pass-through.

13 Now, with regard to reseller testimony,
14 Mr. Casper told you that we have heard from the
15 resellers own mouths with regard to these
16 declarations.

17 What you will hear when you hear the motion
18 for sanctions is that the testimony, so-called
19 "testimony" for these eight resellers, the
20 declarations were actually declarations drafted by
21 Microsoft counsel, Mr. Hauck.

22 And although Your Honor had denied
23 Microsoft the opportunity to contact class members,
24 Microsoft counsel was out contacting class members,
25 some of whom also happen to be resellers, drafting

1 declarations for them and submitting them in support
2 of this motion for decertification.

3 And as Mr. Jacobs will tell you further
4 about that, when we have tried to take their
5 depositions, we have found that some who were
6 originally going to cooperate and provide clarifying
7 declarations, these individuals were told by
8 Microsoft counsel, "Look, you should get your own
9 lawyer. We will pay for those lawyers." And then
10 the lawyers billed Microsoft as Microsoft defense
11 counsel, and the cooperation that we were hoping to
12 get ceased. And so as a result, we have been unable
13 to get depositions of all of these declarants that
14 submitted these affidavits.

15 But we have succeeded in getting a couple
16 of depositions. And, in fact, early on, Microsoft
17 took the depositions of a couple of resellers. And
18 interestingly, Microsoft didn't cite any testimony
19 from those resellers that they took testimony from.
20 So I find it rather interesting that when we've had
21 the opportunity to cross-examine a reseller, we get
22 information that coincides with Dr. Netz' opinions.
23 But yet when we find that we see declarations drafted
24 by Microsoft counsel, that it isn't quite as the real
25 world turns out to be.

1 So, for instance, here we've got
2 Mr. Orville Erickson of Computer Works. He's the one
3 that sets the pricing, and what he's saying here is
4 generally they operate on a cost plus basis. He's
5 saying that the cost is passed on, pure and simple.

6 So we've got another excerpt from a
7 deposition of Larry Pedersen on page 58:

8 "So you're not going to sell it below
9 cost; right?

10 "Right.

11 "So whatever the actual costs are
12 to you, you're going to pass those through
13 to the customer and recover those costs
14 plus whatever your profit is; correct?

15 "Answer: I'm going to pass through
16 the price and hope that I'm still making a
17 minimum margin. In my mind the cost of
18 it is the cost of the product plus the
19 profit we want to make in it. I want to
20 pass that through.

21 "So the cost to you from the
22 distributor, you want to pass that
23 through plus whatever your profit is;
24 right?

25 "Right."

1 So here were two resellers that we were
2 actually told that Microsoft was noticing up their
3 depositions. We attended, cross-examined. I'm
4 sorry. Pederson was one of the declarants. Orville
5 Erickson was one of ones we were told about.

6 So Pedersen was one of the ones we
7 subsequently served a subpoena on and have actually
8 taken his deposition. And as Your Honor is aware
9 from the Duane Davis scenario, we're still trying to
10 get everything accomplished with that one.

11 Now, in addition, when we're given the
12 opportunity to cross-examine these resellers or OEMs,
13 they tell you what I mentioned earlier was just
14 common, simple, economic sense, and really a very
15 simple concept that the jury is going to understand.

16 So in the Minnesota case there is an
17 individual named Richard Apple, who was with Zeos
18 Computers, and it was his responsibility to price --
19 set the price for Zeos Computers.

20 Now, Zeos had an operation. It was a
21 smaller computer company, but it had sort of a
22 similar operation to Dell, but really before Dell got
23 as large as it was. So, in other words, people would
24 call in and say we would like these components in our
25 computer, this much memory, et cetera.

1 So what Mr. Apple told the jury in
2 Minnesota was that pricing was a challenging process
3 because the distribution channels were so
4 competitive. So consumers could shop around. They
5 could shop. They could cross shop between the
6 finished goods channel and the OEM channel. So he
7 always had to be aware of the competition.

8 So he had to figure out a price where
9 people would still buy the computers, a sufficient
10 number that they would make money, but what he had to
11 do was look at everything that went into the
12 computer. And if he was going to sell the computer,
13 he had to get his cost out plus a reasonable margin.
14 So he did a competitive analysis seeing where his
15 competitors were and what his floor costs were and
16 his competition being somewhere else, that would
17 determine the price he would have to sell the
18 computer at.

19 And Zeos is now out of business, but I bet
20 that if we had data from Zeos Computer, we would find
21 a pass-through rate similar to what we've seen for
22 the other OEMs, you know, between 100 and 110 percent
23 because it's a challenging business. It's highly
24 competitive. They have to recover their costs. They
25 have to pass on those costs, and they do pass them

1 on.

2 Next, we also had the deposition of
3 Andrew Orosz. He worked at Equus Computer. And
4 Equus was an OEM, but I think it also sold on a
5 volume basis. And what did he say?

6 He said basically the same thing as Rick
7 Apple. The price from Equus to the customer is
8 determined by the sales rep for that account. He
9 determines the final markup of the machine.

10 "And when you say markup, what do
11 you mean?"

12 "Equus works on what we call a cost
13 plus model. We will bring product into
14 our warehouse and set a standard cost on
15 that product. The salespeople, when they
16 build an order, will draw parts from the
17 warehouse at that standard cost and add
18 a markup to that for sale to their
19 customer."

20 So, in other words, he goes on to explain,
21 like you saw Mr. Pederson explain, that their markup
22 includes not only freight overhead and so forth, but
23 their profit margin they believe they have to have.
24 So you've got the cost plus the markup going into the
25 sales price.

1 So, whatever those costs were, for
2 instance, Microsoft software, that total cost is
3 being passed on to the purchaser.

4 Let me move to the issue of aggregate
5 damages. Rule 1.274, this Iowa Rule, The court may
6 award any form of relief consistent with the
7 certification order including monetary relief in a
8 lump sum, and I'm paraphrasing.

9 It's abundantly clear to me that this lump
10 sum aggregation of damages is permitted under Iowa
11 law. However, Microsoft disagrees and you heard
12 Mr. Casper cite the In re Hotel Telephone Charges
13 opinion. But that particular decision was --
14 involved fluid recovery, number one. Number two,
15 there was not a 1.274 provision in the federal rules
16 allowing aggregation of damages. And, three, we
17 aren't advocating fluid recovery in this case.

18 Now, we've cited the Peterson v. Davenport
19 School District case to Your Honor. Mr. Casper
20 referred to it. That's 626 N.W.2d 99, and at 106,
21 the Iowa Supreme Court citing Wright Miller writes,
22 "If it is impractical to award discrete individual
23 recoveries, courts must use their discretion and in
24 many instances their ingenuity to shape decrees or to
25 develop procedures for ascertaining damages and

1 distributing relief that would be fair to the
2 parties, but will not involve them in an unduly
3 administration of the award."

4 THE COURT: That assume that the court has
5 some ingenuity?

6 MR. HAGSTROM: Pardon? Did I misspeak?

7 THE COURT: No. That assume the court has
8 some ingenuity; is that right?

9 MR. HAGSTROM: Yep.

10 THE COURT: Okay.

11 MR. HAGSTROM: I think with the help of the
12 parties here, you're going to have plenty of
13 ingenuity.

14 THE COURT: Okay.

15 MR. HAGSTROM: The court goes on and says,
16 "The goal in all instances is to determine the
17 aggregate sum." This is the Iowa Supreme Court
18 saying this. So this isn't quoting Wright Miller.
19 This is Iowa Supreme Court saying, "The goal in all
20 instances is to determine the aggregate sum which
21 fairly represents the claims of the individual class
22 members."

23 And the reason for that is you want to
24 disgorge the violator, whether it's an antitrust
25 violation, whether it's a consumer fraud violation,

1 whatever. You want to disgorge the defendant of the
2 ill-gotten gains, but what defendants constantly do
3 is say, "Oh, well, you have individualized damages
4 issues here. You can't prove this, you can't prove
5 that." So, therefore, if you can't prove with
6 certainty actual damages for each member of the
7 class, guess what? You can't have a class certified.
8 Guess what? We get to keep all the money.

9 That's not the rule generally, number one,
10 and that's not the rule specifically in Iowa. Iowa
11 has adopted the uniform class action statute on this,
12 and this provision is in the statute particularly to
13 address that type of defense.

14 So the rule is clear on its face. There
15 are cases that we've cited that award aggregate
16 damages. The more recent decision is the Peterson v.
17 BASF Corp. decision. This is actually out of
18 Minnesota. It's 657 N.W.2d at 853, and it actually
19 involved a New Jersey Consumer Fraud Act. And that
20 act provided for treble damages, and it also provided
21 that she had to determine ascertainable loss, so
22 similar to this actual damages language in the Iowa
23 Antitrust Act. But the Minnesota court, trial court
24 awarded aggregate sums, approximately \$50 million,
25 and the appellate court approved that.

1 Now, one interesting fact about that case,
2 this particular case had gone up and down the
3 appellate ladder a couple of times. The first appeal
4 had to do with the class certification.
5 Certification was approved on appeal, went back down,
6 they had the trial. They had the damages issue
7 raised, went back up. The defendant was not only
8 raising the aggregate damages issue and other issues,
9 but it said the class should have been decertified.
10 The Minnesota appellate court said, No, that's law of
11 the case. You've already had your day in court on
12 certification, and your day is over with."

13 So the concept that we need to show
14 individualized damages determinations as a basis for
15 defeating class actions was soundly rejected by the
16 Iowa Supreme Court 30 years ago and has been rejected
17 numerous times since then.

18 In the Lucas vs. Pioneer case, it states
19 the proposition, as I believe the Comes court stated,
20 Vignaroli, City of Dubuque, many others, that each
21 plaintiff might be entitled to a different sum of
22 money damages. Even if that's the case, that does
23 not furnish a basis for denying or sustaining the
24 case as a class action.

25 In the Vignaroli case, more recent case

1 from '85, "In any event, the fact that a potential
2 class action involves individual damage questions
3 does not preclude class action certification when
4 issues of liability are common to the class."

5 So what we have in the Peterson decision by
6 the Iowa Supreme Court, the goal is to determine the
7 aggregate sum.

8 Microsoft says, "No, you can't do the
9 aggregate sum." But then on the other hand,
10 Microsoft says, "Oh, you have to prove with precision
11 each individual claim so, therefore, since you can't
12 do that you can't do either and guess what? You're
13 out of luck."

14 Well, it doesn't work that way, and based
15 upon the grid system that Dr. Netz has developed and
16 will be presented to the jury -- she has a grid
17 showing individual overcharges by product, by month,
18 by year during the course of the class period. The
19 jury is going to be presented with that evidence.
20 They are also going to be presented with the
21 aggregate sum of damages that you saw earlier today.

22 And so the jury is going to be asked to
23 make a decision, and we believe that we're going to
24 be able to prove damages on an individual basis as
25 well as the aggregate.

1 Now, with regard to the so-called "new
2 claims," Microsoft says that, "Look, there's this new
3 claim for damages for security and new claims for
4 suppression of innovation."

5 Well, as I think Microsoft agrees, these
6 are damages claims. In other words, they arise out
7 of the same common nucleus of facts. These aren't
8 separate causes of actions. And this is
9 demonstrated, for instance, by a case called
10 Dickerson. It's not an antitrust case, but on appeal
11 the defendants in Dickerson were arguing that
12 emotional distress should not have been" -- "damages
13 for emotional distress should not have been awarded."
14 But the Supreme Court said, "No, emotional distress
15 is not the gravamen of the action. It's merely an
16 item of damage."

17 So what we've here and what you'll hear
18 from people like Dr. Frederick Warren-Boulton, one of
19 our experts, "As a result of Microsoft's conduct,
20 there has been damage to consumer welfare." And the
21 consumer welfare, we contend, is made up of three
22 types of damages: Overcharges, suppression of
23 innovation damages, and the security damages. They
24 did not overlap. They are all complementary, and
25 they all result from Microsoft's anticompetitive

1 conduct.

2 Now, Microsoft says that these claims are
3 new. Well, paragraph 2 of our third amended
4 petition, the operative one at the time of class
5 certification in this case, we had the overcharge,
6 denial of free choice, denial of innovation. Those
7 allegations were also reflected in paragraph 20d of
8 that petition. These particular damages claims, in
9 other words, claims for types of injury, were not
10 only in the third amended petition at the time of
11 class certification, but we included them in the
12 fourth amended petition. So they were there at the
13 time of the prior class certification.

14 Now, let me go back to the Comes decision.
15 The Iowa Supreme Court said, "When common questions
16 represent a significant aspect of the case and they
17 can be resolved for all members of the class in a
18 single adjudication, there is a clear justification
19 for handling the dispute on a representative rather
20 than an individual basis." That's, of course, what
21 we have here.

22 And Microsoft would have you decertify even
23 though all of the class members have common
24 complaints. The Iowa Supreme Court says their
25 individual injury doesn't have to be identical,

1 doesn't have to be the same, but what they need are
2 common complaints. We've got common questions of
3 liability. We have common questions of impact. We
4 have common questions of damages.

5 Now, as I mentioned in the third amended
6 petition, we clearly had claims about not only
7 overcharges, but the innovation-type claims as well.
8 Those continue to be the case.

9 Microsoft attacked the class certification
10 on that basis and that was rejected.

11 With regard to the security claims,
12 Microsoft suggests that -- "Well, these are new
13 claims." Well, those fit within the broad
14 allegations of the third amended petition, and I
15 think I understand that Mr. Casper is suggesting that
16 the security damages differ by class member. But in
17 order to do that, what he said was that you have
18 these problems by viruses infecting a computer. We
19 aren't claiming losses or damages for the viruses
20 infecting the computer.

21 What we're claiming is what Your Honor has
22 found through collateral estoppel. And it was
23 interesting that Mr. Casper, as well as other
24 Microsoft counsel, continues to use alleged
25 anticompetitive conduct, alleged this, alleged that.

1 The specific findings of fact for which
2 there are collateral estoppel, including 173 and 174
3 among others, establish -- and this is for all class
4 members who have Windows -- and so all class members
5 have to have Windows to be a member of the class.

6 So Microsoft bolted IE to every copy of
7 Windows it sold. Microsoft's motivation for doing
8 this was the same for everybody: To foreclose
9 Netscape from the market, to require Web developers
10 then to write code to match with IE as opposed to
11 Netscape. IE had the overabundance of code
12 specifically for that purpose, and Your Honor heard
13 that in the summary judgment motions. As a result of
14 that, it increased the attack surface of Microsoft
15 Internet Explorer. And as a result of that attack
16 surface, Microsoft then decided, "Well, we've got to
17 issue security patches to address this situation."

18 It has, in fact, issued 113 security
19 patches, as least as when the expert reports were
20 due, and those 113 security patches are for IE.

21 Now, surprisingly, Mr. Casper mentioned
22 Outlook and Outlook Express earlier. We aren't
23 making our claims with regard to anticompetitive
24 conduct with regard to IE. We don't mention anywhere
25 Outlook and Outlook Express in our expert reports as

1 a basis for these damages.

2 So the net result is that people are
3 required to download these patches or run the risk of
4 catastrophe. And Professor Gowrisankaran presents
5 his economic model on damages for every class member.

6 Now, Microsoft disputes that economic
7 model, as they are entitled to do so, and they can do
8 so in front of the jury, but that's where it needs to
9 be decided. Despite having twelve experts, six
10 economists, not one came up with any particular
11 reason why Dr. Gowrisankaran's methodology was
12 improper. They pick here and there, but they didn't
13 present any alternatives. So this, again, is a
14 battle of the experts.

15 And Mr. Casper also assumes there's only
16 one way possible for plaintiffs to measure damages
17 for security vulnerabilities, and that's for, as I
18 mentioned, harm as a result of viruses. And, of
19 course, this ignores the actual theory used by Dr.
20 Gowrisankaran, which is based upon the detailed
21 technology report of Richard Smith. And Mr. Casper
22 misrepresents that our experts have no "but for"
23 theory. In fact they do. It's been presented.

24 Mr. Casper also ignores the fact that
25 Microsoft has not presented an economist

1 contradicting Professor Gowrisankaran. And so what
2 really is going on here is a typical process of
3 setting up a straw man, an irrelevant straw man, and
4 knocking it down. "Irrelevant straw man" means
5 nothing for purposes of this motion.

6 Microsoft has determined that installing
7 the patches is the least costly way of dealing with
8 the issue. I think Mr. Casper also mentioned
9 something about you have to use the Internet to get
10 exposed. Not really. You can share files with
11 others without using the Internet. And Microsoft
12 does not say, "Well, if you don't use the Internet,
13 don't bother with these patches." These, again, are
14 all issues of fact. They are battles of the experts,
15 and they are improper for purposes of a certification
16 issue.

17 So we have our experts who have their
18 models for measuring the damages to class members,
19 and the jury is going to either accept, reject, parse
20 it out somehow, but that's ultimately for the trier
21 of fact.

22 With regard to volume licensees, I don't
23 believe Microsoft -- well, I guess, based upon their
24 brief, I didn't think Microsoft denied that they
25 presented the issue of volume licensees back in 2003,

1 but based upon the argument today, I think there is
2 such a denial.

3 And although the Iowa Supreme Court's
4 ruling is the law of the case, Microsoft now says
5 that volume licensees should be carved out of the
6 class because the claims are not typical of class
7 representative claims.

8 Microsoft says there is new evidence and it
9 cites out-of-context statements by our experts as
10 supposedly something new that now permits them to
11 come forward and say, "This is new, therefore, we
12 need to look at this for purposes of
13 decertification." And as the self-serving statements
14 of its own expert that it now describes as new, even
15 though the expert merely recites the arguments that
16 Microsoft made back in 2003.

17 So essentially what Microsoft is attempting
18 to do is knock out at least 60 percent of the damages
19 numbers by reason of its request that you separate
20 out volume licensees. And, of course, if the number
21 is higher, than there's an even greater effect on
22 class members. But, of course, Mr. Casper doesn't
23 address what Dr. Netz has said: That each of the
24 class members, whether volume or non-volume, are
25 purchasing in the same competitive marketplace.

1 There is competition in both the finished goods
2 channel and the OEM channel.

3 Now, Mr. Casper talked about the Open
4 Select and Enterprise volume licensing programs. All
5 of these programs have been in, included in, every
6 class certification against Microsoft throughout the
7 country. They were included in this class. So
8 Microsoft suggests that, "Well, there are issues of
9 bundling, issues of negotiations," all of this
10 negotiation is still a chatter at the top of any
11 pricing situation. In other words, it doesn't say
12 these large account resellers are not passing through
13 their cost. What it means is they are in fierce
14 competition with other volume resellers, these other
15 large account resellers, to sell to corporations like
16 Principal, Maytag, whoever.

17 So what that means is that their margins
18 get squeezed by reason of the competition. It does
19 not mean that there isn't an overcharge in that same
20 Microsoft software that is, in fact, passed through
21 to these volume licensees, the class members that are
22 in this class.

23 Now, as I mentioned before, Microsoft
24 submitted affidavits by the large account resellers
25 at the time of the prior certification. At the same

1 time they were submitting affidavits in the MDL case,
2 which was called Dieter. In the MDL case, of course,
3 there's In re MDL number such and such. But in the
4 Dieter case -- I stand corrected. The large account
5 resellers were submitted in Dieter. There was
6 internal Microsoft large account reseller personnel
7 within Microsoft that submitted affidavits about the
8 volume licensing pricing negotiation and so forth in
9 the Comes case.

10 So what we did is we took a look over the
11 lunch break -- and, Your Honor, if you don't mind, we
12 have copies of these large account reseller
13 affidavits submitted in the MDL, and these are from
14 the 2002 time frame. And each cover, you'll see, has
15 an exhibit number: CC, DD, and EE. And so these
16 were exhibits submitted in the MDL. And they
17 attached these same resellers, their large account
18 resellers affidavits to the briefs now and said,
19 "This is new evidence." It wasn't new evidence.
20 They had it back in 2002.

21 And what Mr. Casper tells you is that,
22 "Wow, this is new evidence and Professor Paul has
23 come up with this new evidence and these new opinions
24 on the volume licensing segment of the finished goods
25 channel and, therefore, based upon all this new

1 evidence about negotiations, et cetera, you have to
2 decertify or at least separate these folks out."

3 Well, the last document that was just
4 handed to Your Honor is the affidavit of
5 Catherine Morrison Paul, and we just excerpted out
6 over the lunch period a couple of pages from the
7 Appendix C which is, "Documents Considered." And on
8 the first page -- let me just tie it into the other
9 ones that we just handed on up. On page 3, you'll
10 see the second entry, David Stubbs. That is Exhibit
11 CC.

12 The next entry is James Grass. That's
13 Exhibit BB.

14 Then you have four entries down, Larry
15 Malashock. That is Exhibit EE.

16 And further down you've got William Morris,
17 and that's DD.

18 So Microsoft comes into this courtroom and
19 tells Your Honor that this volume licensing is all
20 new. It's all new evidence. And yet their expert
21 didn't do any independent investigation by herself.
22 She relied on old evidence and old arguments of
23 Microsoft that were presented to Judge Reis and to
24 the Iowa Supreme Court and rejected.

25 Now, let's take a look at -- in the

1 Microsoft brief to the Iowa Supreme Court, Microsoft
2 argued the very same thing that Professor Paul is
3 arguing and Mr. Casper argued here. We've got all of
4 these volume licensing issues. There is negotiation.
5 The large account resellers are negotiating. You've
6 got bundling, et cetera. So you'll see that in their
7 brief to the Iowa Supreme Court they have cited the
8 English affidavit and the Zoroza affidavit.

9 If we take a look at the Zoroza
10 affidavit -- you'll notice at the bottom of this
11 affidavit, first page, it's got a "346." That's the
12 appendix number that was submitted to the Iowa
13 Supreme Court. So this was part of the appendix, the
14 joint appendix.

15 So on the second page of the affidavit or
16 Appendix "347," paragraph 4, he's talking about the
17 Open License Program, the Select Program and the
18 Enterprise Program, the very same three that
19 Mr. Casper raised earlier today.

20 In paragraph 6 he's asserting, "The prices
21 for these transactions between the distributors and
22 resellers are negotiated and established
23 independently of Microsoft."

24 "Paragraph 7: The thousands of resellers
25 involved in this distribution channel then sell open

1 licenses to end users. Each reseller sets the price
2 to end user independently of Microsoft."

3 "Paragraph 8: Although Microsoft knows the
4 identify of the customers participating in the Open
5 License Program, neither the distributors nor the
6 resellers inform Microsoft as to how they factor the
7 cost of Microsoft operating systems into the prices
8 they charge their customers."

9 "Paragraph 11" -- this is on the Select
10 Program -- "The price in each of these transactions
11 is negotiated independently of Microsoft."

12 The last sentence on that paragraph, "The
13 LAR and the customer also negotiate payment terms
14 independently of Microsoft."

15 And we move into the Enterprise Program.

16 "Paragraph 15: The customer negotiated its
17 final cost with, and paid the license fee for the
18 Microsoft software to the LAR, not Microsoft."

19 "Paragraph 16: The Enterprise customer
20 then negotiated the price with the LAR independently
21 of Microsoft."

22 And the affidavit of Daniel English
23 basically says the same types of things, so I don't
24 want to waste further time on that.

25 And if Your Honor wants to take a look at

1 the other exhibits, BB, CC, DD and EE, you'll see
2 that these large account resellers say basically same
3 thing, that they are presented with very competitive
4 markets. They do negotiate prices with their
5 customers. When they are addressing or trying to
6 sell their products in a competitive market, of
7 course, they have to be very competitive in their
8 pricing and they look to others -- they look to the
9 pricing of others so they remain competitive.

10 So let me direct your attention to one more
11 thing in Exhibit BB, which is a declaration of James
12 Grass, at paragraph 3.

13 Now, Grass is from CDW Computer, which is
14 one of the large account resellers that Mr. Casper
15 mentioned.

16 "Paragraph 3: The majority of CDW's
17 customers are small to medium-sized businesses." So
18 these are the types of businesses that may be
19 purchasing on a volume basis or a non-volume basis.

20 And he goes on to talk about how
21 competitive the market vis-a-vis other LARs, and how
22 Enterprise Agreement and Select customers frequently
23 engaged in comparison shopping based on price.

24 Well, again, when you have competition
25 between these LARs or resellers, that competition

1 dictates, number one, that you have to pass your cost
2 through; and, number two, you've got very thin profit
3 margins.

4 So suffice it to say, that when Mr. Casper
5 told you this is all brand-new, the evidence
6 demonstrates that it is not.

7 And I would also point out that in the
8 Malashock declaration, paragraph 6, he says,
9 "Software Plus faced stiff competition from other
10 resellers of software, including, but not limited to,
11 other LARs." So in other words, there's cross
12 channel competition. So they have to be pricing
13 considering what retailers are doing, what other LARs
14 are doing and other OEMs are doing. There's cross
15 channel competition. That is why because of that
16 competition margins are low. And when you have low
17 margins in distribution channels like that, you have
18 to pass on.

19 When I say, "to have to pass on," you have
20 to pass on as a matter of business survival.

21 But I just was reminded, Mr. Casper was
22 saying that Dr. Netz had to find a certain number. I
23 wasn't quite sure what that meant, but you read
24 Dr. Netz' expert report. It's clear that she didn't
25 have to find any particular number with regard to

1 pass-through. She did the studies. Based upon
2 economic principals, she believed they would
3 ultimately establish a full pass-through, but she
4 didn't assume it. She tested it. She look at
5 varying types of evidence, plus she did several
6 corroboration studies.

7 Now, let me move on to the typicality
8 issue. As we saw earlier -- just a second, Your
9 Honor, I'm looking for something.

10 Typicality is not part of the rule in Iowa.
11 You look at 1.261, 1.262, 1.263, you don't see it.

12 Microsoft relies on the Iowa Supreme Court
13 decision in Hammer v. Branstad from 1990, well, of
14 course, that preceded by some 15 years the Iowa
15 Supreme Court's decision in Comes.

16 Well, Mr. Casper says that Hammer, the Iowa
17 Supreme Court in Hammer said there is a typicality
18 requirement for class certification.

19 Well, let's actually take a look at what
20 the court says on page 89, which is 463 N.W.2d at 89,
21 "We have recognized a standing requirement for class
22 representatives by stating that a class
23 representative must be a member of the class sought
24 to be represented," citing the Vignaroli decision.
25 It says, "This concept is discussed in the following

1 commentary," and they cite Newberg.

2 Well, in the Newberg lengthy paragraph, the
3 claims -- the typicality under federal law is
4 discussed. But at the end it says, "Many courts have
5 expressed this rule of qualification for class
6 representative as a requirement that the class
7 plaintiff have shared standing with or be a part of
8 or a member of the class."

9 So then the Iowa Supreme Court goes on to
10 say: "Applying this test to the present factual
11 situation, we agree with the defendants that the Iowa
12 Nurses' Association does not have standing to
13 litigate the monetary claims being made on behalf of
14 the class." Why? Because they simply were not
15 members of the class. They weren't injured as class
16 members.

17 So the Iowa Supreme Court didn't say you've
18 got to have typicality.

19 Now, since they don't have typicality in
20 the Iowa rule, Microsoft looks to federal cases.
21 Well, federal cases are different. Rule 23 is
22 different, and they rely upon Hammer, which a
23 standing case. Hammer stands for the simple
24 proposition that a class representative must, in
25 fact, be a member of the class as defined. And

1 Microsoft argued that the class representatives were
2 not properly members of the class in the first class
3 certification process. The Iowa Supreme Court
4 rejected that.

5 Now, there simply is no evidentiary basis
6 for cutting out the volume purchaser claims, and if
7 you take a look at -- the Iowa Supreme Court at 322
8 says, "We have never suggested a class plaintiff must
9 show there will be common proof on each element of
10 the claim." And, "The class action device is
11 appropriate only where class members have common
12 complaints that can be presented by designated
13 representatives in the unified proceeding. This does
14 not, however, mean that the individual claims be
15 carbon copies of each other."

16 So, in other words, they have to have
17 common complaints. They have to complain. In other
18 words, there's common issues. There's common issues:
19 Did Microsoft violated the antitrust laws? Did
20 Microsoft monopolize certain relevant markets? Did
21 Microsoft unreasonably restrain trade? Did Microsoft
22 overcharge for its products? Did Microsoft injure
23 class members by reason of unlawfully bolting IE to
24 Windows? These are common complaints. Those in and
25 of themselves are what class certifications are all

1 about.

2 Now, Microsoft asserts that the volume
3 licensee channel or segment of the channel, the
4 finished goods channel, is different. And in this
5 particular slide, and this an exhibit to the Dr. Netz
6 expert report, on the right-hand column you see the
7 "retail" segment of the finished goods channel, and
8 the "corporate" segment, the volume licensee segment.
9 And you see based upon all those pass-through studies
10 of those companies, the pass-through rate exceeds 100
11 percent. The weighted average is actually 107
12 percent.

13 Now, Microsoft also says that new evidence
14 comes from plaintiffs' experts.

15 Page 37 of the reply brief, they argue that
16 plaintiffs ignore that Microsoft has presented new
17 evidence that demonstrates why the court should now
18 exclude volume licensees. That evidence includes
19 plaintiffs' own expert reports which demonstrate that
20 plaintiffs cannot despite their promises use common
21 evidence to prove the claims of volume licensees. So
22 Microsoft is saying, "Wow, we've got a revelation
23 here. In plaintiffs' own expert reports, there's now
24 new evidence, some new admission that volume
25 licensees are different. So because of this new

1 evidence just discovered since these expert reports
2 were filed on June 2, 2006, Your Honor has to exclude
3 them from the class."

4 Well, let's take a look.

5 THE COURT: This might be a good time to
6 break.

7 See you at nine o'clock tomorrow morning.

8 (Record closed on October 11, 2006, at
9 4:28 p.m.)

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1 CERTIFICATE TO TRANSCRIPT

2 The undersigned, Janis A. Lavorato, one of
3 the Official Court Reporters in and for the Fifth
4 Judicial District of Iowa, which embraces the County
5 of Polk, hereby certifies:

6 That she acted as such reporter in the
7 above-entitled cause in the District Court of Iowa,
8 for Polk County, before the Judge stated in the title
9 page attached to this transcript, and took down in
10 shorthand the proceedings had at said time and place.

11 That the foregoing pages of typed written
12 matter is a full, true and complete transcript of
13 said shorthand notes so taken by her in said cause,
14 and that said transcript contains all of the
15 proceedings had at the times therein shown.

16 Dated at Des Moines, Iowa, this 27th day of
17 October, 2006.

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JANIS A. LAVORATO

20 Certified Shorthand Reporter

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