IN THE IOWA DISTRICT COURT FOR POLK COUNTY

JOE COMES; RILEY PAINT, an Iowa Corporation; SKEFFINGTON'S FORMAL WEAR OF IOWA, INC., an Iowa Corporation; PATRICIA ANNE LARSEN; and MIDWEST COMPUTER REGISTER CORP., an Iowa Corporation,

Plaintiffs,

vs.

MICROSOFT CORPORATION,

Defendant.

NO. CL82311

TRANSCRIPT OF PROCEEDINGS

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

JANIS A. LAVORATO
Certified Shorthand Reporter
Room 405B-Polk County Courthouse
Des Moines, Iowa 50309

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PROCEEDINGS

(The following record commenced at 9 a.m. on October 11, 2006.)

THE COURT: All right. Mr. Hagstrom is here. Ms. Kniffen.

MS. KNIFFEN: Kniffen.

THE COURT: Ms. Kniffen. Mr. Williams?

MR. WILLIAMS: That's right, Your Honor. Good morning.

THE COURT: Mr. Jacobs. Mr. Green. Are you Mr. Nelson or Casper?

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

THE COURT: Casper. So we have all the parties here. Did you get that down?

We're here on the issue now of the decertification of the classes.

Are the defendants ready to proceed?

MR. CASPER: Yes, Your Honor.

THE COURT: Please proceed.

MR. CASPER: Your Honor, Charles Casper for Microsoft. I'm sitting here at counsel table feeling very outgunned, but we will try to carry on nonetheless.

Your Honor, it's been more than three years

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

were injured.

And he said that they should be able to do that because the resellers who buy from Microsoft must pass-through any cost increases including cost increases attributable to the overcharge the plaintiffs allege. He said they "must" do that. Well, at the time there was no evidence one way or another of what they actually did, but now there is.

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

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

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

changes that have been made there.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

may require revisiting upon the completion of full discovery."

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

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

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

plaintiffs, it proves everybody's claims.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

And, indeed, two of the resellers who

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

The Iowa rule also requires that the

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

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

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

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

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

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

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

THE COURT: Is that the jump cite?

MR. CASPER: Yes, at page 89.

THE COURT: Give me the first one.

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

THE COURT: Thanks.

MR. CASPER: And Hammer v. Branstad took

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

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

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

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

THE COURT: Is that a Court of Appeals decision?

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

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

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

customers. The same is true for Open customers.

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

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

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

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

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

Well, two responses to that:

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Now, first of all, the plaintiffs themselves have narrowed their claims somewhat by giving up the ghost on one of them. They added three claims that I want to point out to the court here. One was a lack of product choice, the second was this

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

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

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

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

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

THE COURT: I'm kidding.

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

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

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

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

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

Actual damages.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Mr. Hagstrom said: "Object to form."

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

That means that even under the plaintiffs'

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

THE COURT: Sure.

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

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

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

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

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

Then the price went down. Then it went

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

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

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

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

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

choose to sell below cost. Here is an example.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

That's right. They do make money on

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

And this data analysis shows unmistakably that companies are choosing to absorb some or all of the cost changes for various periods of time for whatever reasons they have for doing it. They do it. And this supports what the resellers said they do. So it all adds up.

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

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

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

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

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

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

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

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

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

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

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

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

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

THE COURT: Is it okay to take a recess?

MR. CASPER: Yes. Yes, Your Honor.

THE COURT: 15 minutes. Thank you.

(A short recess was taken.)

Continue, Mr. Casper.

MR. CASPER: Thank you, Your Honor.

Before I sit down, Your Honor, I would like to respond to a couple of the points that the plaintiffs made in their resistance to the point we made here. You'll recall the reason for running this analysis was to see if Professor -- or, rather, Dr. Netz was right that all the products were the same, and she clearly wasn't. So the products were separated out to see if the resellers, in fact, looked at them, the same products differently or not, and, of course, they did.

The plaintiffs in their resistance said, "Well, what Microsoft did was they sliced and diced the data such that it's not going to produce any good results," and that is not at all what happened. What we did here was we simply took groups that Dr. Netz herself recognized were significant groups, the groups that are used in this column under "b" are operating systems, didn't even distinguish between operating systems. It's just operating systems: Office -- not different versions -- just Office;

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

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

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

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

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

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

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

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

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

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

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

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

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

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

But when the dispute is over the question

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

really okay.

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

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

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

seek redress for their constitutional rights.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Thank you, Your Honor.

THE COURT: Thank you.

Response.

MR. HAGSTROM: Thank you, Your Honor.

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

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

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

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

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

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

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

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

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

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

class members.

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

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

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

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

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

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

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

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

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

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

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

We also included allegations about

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

THE COURT: You mean Comes?

MR. HAGSTROM: Pardon?

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

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

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

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

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

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

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

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

Now, let me be very clear about one thing.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Similarly, the court in Bogosian v. Gulf

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

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

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

MR. HAGSTROM: That is great.

Thank you, Your Honor.

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

(A noon recess was taken.)

THE COURT: Mr. Hagstrom, continue.

MR. HAGSTROM: Thank you, Your Honor.

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

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

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

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

And as I mentioned, Microsoft makes the

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

pass-through issues."

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Professor MacKie-Mason and Dr. Netz are

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

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

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

MR. HAGSTROM: Right.

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

MR. HAGSTROM: Probably.

MR. GREEN: We wish.

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

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

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

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

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

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

Judge Reis agreed with us. The Iowa

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

1.261, 1.262 and 1.263 and typicality is not there. And, of course, at the same time they were not arguing typicality to Judge Reis or to the Iowa Supreme Court, they were arguing typicality in the Deiter -- in the Deiter case as part of the MDL and then ultimately to the Fourth Circuit.

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

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

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

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

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

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

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

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

Well, as we already mentioned, none of this

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

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

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

Court, and they were rejected.

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

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

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

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

But that's not the situation we have here. We have the Iowa Supreme Court addressing every single one of the arguments that Microsoft has raised.

Now, Microsoft also mentions the Vos case. That was a case in which a class was decertified, and in that particular case the -- and that was what is called a life insurance vanishing premium case. In other words, it's where consumers buy a life insurance policy and they are told after x number of years, your dividends will exceed your premium and, therefore, after that x number of years, you will no longer have to be paying a premium. So that's why it's called a "vanishing premium" case.

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

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

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

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

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

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

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

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

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

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

So I want to turn to the concept of pass-

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

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

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

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

Organization v. AMPI case.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

original equipment manufacturers where software is preinstalled.

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

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

high degree of competition in these channels.

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

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

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

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

there is some differences based upon this new evidence.

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

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

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

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

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

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

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

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

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

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

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

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

As I mentioned, the Iowa Supreme Court

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

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

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

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

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

Now, with regard to the attacks on the

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

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

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

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

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

profit margin and rate of return, price premium method does not use pass-through.

And I was just reminded that Microsoft is not challenging the price premium method in their brief.

Now, Microsoft showed you some charts and they talked about the issue of overcharge, whether a cost increase gets passed through in terms of retail prices.

In fact, Microsoft even concludes that there is no relationship between the two. So Microsoft further concludes that since an overcharge was a cost, this necessarily means there was no relationship between the overcharge and retail prices.

So Microsoft says that retail prices were not affected by the overcharge and end users were not injured. That's sort of the theory they follow.

And you saw this chart, one very similar to it, presented to you by Mr. Casper. This comes out of Dr. Paul's affidavit.

And I think this is part of its reply brief. It shows prices for this OEM at a stable amount, and it purports to show costs differing over time. And Microsoft says, "Look, obviously there's

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

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

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

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

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

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

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

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

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

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

So she says pass-through involves the

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Microsoft is simply incorrect.

Your Honor, if I could hand up.

THE COURT: Sure. Thank you.

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

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

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

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

here.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

direct relationship with price.

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

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

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

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

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

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

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

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

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

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

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

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

scenario by Microsoft.

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

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

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

MR. HAGSTROM: That's great.

(A short recess was taken.)

THE COURT: Mr. Hagstrom.

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

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

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

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

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

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

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

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

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

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

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

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

"Right.

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

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

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

"Right."

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

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

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

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

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

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

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

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

on.

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

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

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

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

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

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

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

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

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

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

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

MR. HAGSTROM: Pardon? Did I misspeak?

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

MR. HAGSTROM: Yep.

THE COURT: Okay.

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

THE COURT: Okay.

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

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

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

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

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

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

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

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

In the Vignaroli case, more recent case

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

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

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

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

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

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

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

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

conduct.

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

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

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

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

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

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

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

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

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

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

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

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

a basis for these damages.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

And what Mr. Casper tells you is that, "Wow, this is new evidence and Professor Paul has come up with this new evidence and these new opinions on the volume licensing segment of the finished goods channel and, therefore, based upon all this new

evidence about negotiations, et cetera, you have to decertify or at least separate these folks out."

Well, the last document that was just handed to Your Honor is the affidavit of Catherine Morrison Paul, and we just excerpted out over the lunch period a couple of pages from the Appendix C which is, "Documents Considered." And on the first page -- let me just tie it into the other ones that we just handed on up. On page 3, you'll see the second entry, David Stubbs. That is Exhibit CC.

The next entry is James Grass. That's Exhibit BB.

Then you have four entries down, Larry Malashock. That is Exhibit EE.

And further down you've got William Morris, and that's DD.

So Microsoft comes into this courtroom and tells Your Honor that this volume licensing is all new. It's all new evidence. And yet their expert didn't do any independent investigation by herself. She relied on old evidence and old arguments of Microsoft that were presented to Judge Reis and to the Iowa Supreme Court and rejected.

Now, let's take a look at -- in the

Microsoft brief to the Iowa Supreme Court, Microsoft argued the very same thing that Professor Paul is arguing and Mr. Casper argued here. We've got all of these volume licensing issues. There is negotiation. The large account resellers are negotiating. You've got bundling, et cetera. So you'll see that in their brief to the Iowa Supreme Court they have cited the English affidavit and the Zoroza affidavit.

If we take a look at the Zoroza affidavit -- you'll notice at the bottom of this affidavit, first page, it's got a "346." That's the appendix number that was submitted to the Iowa Supreme Court. So this was part of the appendix, the joint appendix.

So on the second page of the affidavit or Appendix "347," paragraph 4, he's talking about the Open License Program, the Select Program and the Enterprise Program, the very same three that Mr. Casper raised earlier today.

In paragraph 6 he's asserting, "The prices for these transactions between the distributors and resellers are negotiated and established independently of Microsoft."

"Paragraph 7: The thousands of resellers involved in this distribution channel then sell open

licenses to end users. Each reseller sets the price to end user independently of Microsoft."

"Paragraph 8: Although Microsoft knows the identify of the customers participating in the Open License Program, neither the distributors nor the resellers inform Microsoft as to how they factor the cost of Microsoft operating systems into the prices they charge their customers."

"Paragraph 11" -- this is on the Select Program -- "The price in each of these transactions is negotiated independently of Microsoft."

The last sentence on that paragraph, "The LAR and the customer also negotiate payment terms independently of Microsoft."

And we move into the Enterprise Program.

"Paragraph 15: The customer negotiated its final cost with, and paid the license fee for the Microsoft software to the LAR, not Microsoft."

"Paragraph 16: The Enterprise customer then negotiated the price with the LAR independently of Microsoft."

And the affidavit of Daniel English basically says the same types of things, so I don't want to waste further time on that.

And if Your Honor wants to take a look at

the other exhibits, BB, CC, DD and EE, you'll see that these large account resellers say basically same thing, that they are presented with very competitive markets. They do negotiate prices with their customers. When they are addressing or trying to sell their products in a competitive market, of course, they have to be very competitive in their pricing and they look to others -- they look to the pricing of others so they remain competitive.

So let me direct your attention to one more thing in Exhibit BB, which is a declaration of James Grass, at paragraph 3.

Now, Grass is from CDW Computer, which is one of the large account resellers that Mr. Casper mentioned.

"Paragraph 3: The majority of CDW's customers are small to medium-sized businesses." So these are the types of businesses that may be purchasing on a volume basis or a non-volume basis.

And he goes on to talk about how competitive the market vis-a-vis other LARs, and how Enterprise Agreement and Select customers frequently engaged in comparison shopping based on price.

Well, again, when you have competition between these LARs or resellers, that competition

dictates, number one, that you have to pass your cost through; and, number two, you've got very thin profit margins.

So suffice it to say, that when Mr. Casper told you this is all brand-new, the evidence demonstrates that it is not.

And I would also point out that in the Malashock declaration, paragraph 6, he says, "Software Plus faced stiff competition from other resellers of software, including, but not limited to, other LARs." So in other words, there's cross channel competition. So they have to be pricing considering what retailers are doing, what other LARs are doing and other OEMs are doing. There's cross channel competition. That is why because of that competition margins are low. And when you have low margins in distribution channels like that, you have to pass on.

When I say, "to have to pass on," you have to pass on as a matter of business survival.

But I just was reminded, Mr. Casper was saying that Dr. Netz had to find a certain number. I wasn't quite sure what that meant, but you read Dr. Netz' expert report. It's clear that she didn't have to find any particular number with regard to

pass-through. She did the studies. Based upon economic principals, she believed they would ultimately establish a full pass-through, but she didn't assume it. She tested it. She look at varying types of evidence, plus she did several corroboration studies.

Now, let me move on to the typicality issue. As we saw earlier -- just a second, Your Honor, I'm looking for something.

Typicality is not part of the rule in Iowa. You look at 1.261, 1.262, 1.263, you don't see it.

Microsoft relies on the Iowa Supreme Court decision in Hammer v. Branstad from 1990, well, of course, that preceded by some 15 years the Iowa Supreme Court's decision in Comes.

Well, Mr. Casper says that Hammer, the Iowa Supreme Court in Hammer said there is a typicality requirement for class certification.

Well, let's actually take a look at what the court says on page 89, which is 463 N.W.2d at 89, "We have recognized a standing requirement for class representatives by stating that a class representative must be a member of the class sought to be represented," citing the Vignaroli decision. It says, "This concept is discussed in the following

commentary," and they cite Newberg.

Well, in the Newberg lengthy paragraph, the claims -- the typicality under federal law is discussed. But at the end it says, "Many courts have expressed this rule of qualification for class representative as a requirement that the class plaintiff have shared standing with or be a part of or a member of the class."

So then the Iowa Supreme Court goes on to say: "Applying this test to the present factual situation, we agree with the defendants that the Iowa Nurses' Association does not have standing to litigate the monetary claims being made on behalf of the class." Why? Because they simply were not members of the class. They weren't injured as class members.

So the Iowa Supreme Court didn't say you've got to have typicality.

Now, since they don't have typicality in the Iowa rule, Microsoft looks to federal cases. Well, federal cases are different. Rule 23 is different, and they rely upon Hammer, which a standing case. Hammer stands for the simple proposition that a class representative must, in fact, be a member of the class as defined. And

Microsoft argued that the class representatives were not properly members of the class in the first class certification process. The Iowa Supreme Court rejected that.

Now, there simply is no evidentiary basis for cutting out the volume purchaser claims, and if you take a look at -- the Iowa Supreme Court at 322 says, "We have never suggested a class plaintiff must show there will be common proof on each element of the claim." And, "The class action device is appropriate only where class members have common complaints that can be presented by designated representatives in the unified proceeding. This does not, however, mean that the individual claims be carbon copies of each other."

So, in other words, they have to have common complaints. They have to complain. In other words, there's common issues. There's common issues: Did Microsoft violated the antitrust laws? Did Microsoft monopolize certain relevant markets? Did Microsoft unreasonably restrain trade? Did Microsoft overcharge for its products? Did Microsoft injure class members by reason of unlawfully bolting IE to Windows? These are common complaints. Those in and of themselves are what class certifications are all

about.

Now, Microsoft asserts that the volume licensee channel or segment of the channel, the finished goods channel, is different. And in this particular slide, and this an exhibit to the Dr. Netz expert report, on the right-hand column you see the "retail" segment of the finished goods channel, and the "corporate" segment, the volume licensee segment. And you see based upon all those pass-through studies of those companies, the pass-through rate exceeds 100 percent. The weighted average is actually 107 percent.

Now, Microsoft also says that new evidence comes from plaintiffs' experts.

Page 37 of the reply brief, they argue that plaintiffs ignore that Microsoft has presented new evidence that demonstrates why the court should now exclude volume licensees. That evidence includes plaintiffs' own expert reports which demonstrate that plaintiffs cannot despite their promises use common evidence to prove the claims of volume licensees. So Microsoft is saying, "Wow, we've got a revelation here. In plaintiffs' own expert reports, there's now new evidence, some new admission that volume licensees are different. So because of this new

evidence just discovered since these expert reports were filed on June 2, 2006, Your Honor has to exclude them from the class."

Well, let's take a look.

THE COURT: This might be a good time to break.

See you at nine o'clock tomorrow morning.

(Record closed on October 11, 2006, at 4:28 p.m.)

CERTIFICATE TO TRANSCRIPT

The undersigned, Janis A. Lavorato, one of the Official Court Reporters in and for the Fifth Judicial District of Iowa, which embraces the County of Polk, hereby certifies:

That she acted as such reporter in the above-entitled cause in the District Court of Iowa, for Polk County, before the Judge stated in the title page attached to this transcript, and took down in shorthand the proceedings had at said time and place.

That the foregoing pages of typed written matter is a full, true and complete transcript of said shorthand notes so taken by her in said cause, and that said transcript contains all of the proceedings had at the times therein shown.

Dated at Des Moines, Iowa, this 27th day of October, 2006.

_____

JANIS A. LAVORATO

Certified Shorthand Reporter