AOL Time Warner and Microsoft End a Bitter Rivalry

Bill Gates, left, chairman of Microsoft, and Richard D. Parsons, chairman of AOL Time Warner, said their companies' cooperation could speed the delivery of digital information and entertainment over the Internet.

By STEVE LOHR and DAVID D. KIRKPATRICK

Microsoft agreed to pay AOL Time Warner $750 million in a legal settlement yesterday that ends one of the most bitter rivalries in modern corporate history and commits the two companies to a sweeping program of business cooperation.

Under the agreement, Microsoft will grant AOL a seven-year royalty-free license to its Internet browsing software, and faster and greater access to Microsoft's Windows operating system. That will make it easier for AOL's popular online service to work with Windows software, which runs more than 90 percent of all personal computers.

Microsoft will also grant AOL Time Warner a long-term license to its software for delivering music and video over the Internet. Microsoft vowed to work closely with AOL Time Warner to develop software to protect AOL's movie and music assets from piracy. The two companies also agreed to discuss how to open up their networks for sending and receiving instant messages over the Internet, although they have said similar things before.
The unexpected alliance between the corporate titans reflects a fundamental change in direction for both companies with the fading of the fad for convergence between technology and media companies.

AOL Time Warner is far less a technology company than it once was. Its Netscape subsidiary, the commercial pioneer in Web browsing software and the star witness in the government's antitrust case against Microsoft, has shriveled.

At the same time, Microsoft — which made a flurry of investments in the 1990’s that led many media executives to say they feared that Microsoft might overwhelm them — has recently focused on its basic software business.

Strategically, the two companies — though still competitors in some fields — have largely returned to their traditional corners.

"This is the end of a long war," said David B. Yoffie, a professor at the Harvard Business School. "AOL Time Warner is much more of a pure media company, while Microsoft has returned much more to its software roots."

The cooperation agreement includes a $750 million payment from Microsoft to settle a private antitrust suit brought by the Netscape unit of AOL Time Warner in January 2002. The private case followed a ruling by a federal appeals court in the long-running suit against Microsoft, brought by the government in 1998; the judge ruled that the company had repeatedly violated antitrust laws by thwarting competition to preserve its monopoly in personal computer operating systems. In the government case, Netscape was portrayed as the principal corporate victim. Microsoft, the court ruled, repeatedly bullied PC makers and others to favor its browser over Netscape.

The $750 million payment is a huge legal settlement, though it represents little more than pocket change to Microsoft, which has more than $40 billion in cash in the bank. The company, which paid only legal fees as part of its agreement with the Justice Department and several states to modify its future behavior, still faces other antitrust challenges, including an investigation by the European Union and a private suit by Sun Microsystems, a competitor.

But the settlement removes a major legal uncertainty for Microsoft, which could have eventually been forced to pay billions in damages, according to legal experts. And Microsoft has taken a more conciliatory
stance toward competitors generally in the last year or so.

"There is a message here about putting past differences behind us," Bill Gates, Microsoft's co-founder and chairman, said in an interview.

New leadership at AOL Time Warner, according to analysts, smoothed the way for an agreement, as well. The former chairman of AOL Time Warner, Stephen M. Case, who stepped down this month, often clashed with Mr. Gates, Microsoft's equally combative chairman. Mr. Case was the entrepreneurial leader behind America Online's rise to become the leading online service, and he bought Netscape in 1999 for $10 billion to confront Microsoft head-on.

Mr. Case's successor, Richard D. Parsons, said Mr. Case was kept informed at every step of the negotiations, but others at the company said Mr. Parsons eased a path toward a pragmatic agreement.

"It may signal there's a different attitude toward doing business," Mr. Parsons said in an interview. "We're putting the past behind us."

Both Mr. Parsons and Mr. Gates emphasized that their collaboration could accelerate the delivery of various forms of digital information and entertainment over the Internet. A major obstacle to that development has been the worries of media companies that they will suffer from widespread piracy, as the music industry has. The technology to try to protect such copyrighted material is called digital rights management.

The agreement, Mr. Gates said, carried a message that "Microsoft is focused on the future of digital rights management."

The two companies agreed to cooperate on technology and on public policy matters to "advance the interests of consumers and relevant industries," a joint statement said.

Still, the technology Microsoft will license to AOL Time Warner for sending movies and music over the Internet — Microsoft's Windows Media software — has a strong rival in RealNetworks, an independent company. And Microsoft's deal with AOL Time Warner is not exclusive.

"We have a great relationship with AOL Time Warner," Robert D. Glaser, the chairman of RealNetworks, said. "We have a deep relationship with several divisions, including CNN, their music business and their AOL flagship, and we look forward to keeping those relationships and working with them in the future."

AOL Time Warner and Microsoft still compete in the online business — though Microsoft's MSN is a distant second to AOL. Mr. Gates and Mr. Parsons said those businesses would continue to compete vigorously.

"I think the loveliness of this sort of arrangement," Mr. Parsons said, "is that we have created an environment where AOL and MSN can put
down the war gloves and go out and compete in a level playing field and let the consumers make their choices."

The impact of the agreement is uncertain, consumer advocates said. At best, said Mark Cooper, research director of the Consumer Federation of America, the public might benefit from seamless instant messaging across the AOL and Microsoft networks and a faster adoption of online media. At worst, he said, the two giants might conspire to shut out competitors.

The legal settlement, analysts say, appears to be a calculated tactical move by AOL Time Warner to collect a tidy sum now instead of face the uncertainty of a protracted legal fight. AOL paid $10 billion for Netscape in 1999, and the company might have argued that nearly all that value was lost because of Microsoft's anticompetitive conduct.

Yet Netscape's share of the browser market was already in decline when AOL bought it, and under AOL's stewardship it languished further, with most of the leading software engineers departing.

"AOL Time Warner certainly had a strong case," said Andrew I. Gavil, a law professor at Howard University in Washington, "but it would have been difficult to really measure the dollar damages to Netscape."

Mr. Parsons made it clear he had little stomach for a long-running legal battle, especially given more pressing business concerns at AOL Time Warner. So when Mr. Gates called him about a month and a half ago, Mr. Parsons was amenable to compromise. "I come from a perspective where litigation is rarely constructive," he said. "We got focused on the right things."

For AOL Time Warner, the deal also brings a welcome infusion of cash. The company has promised investors and credit rating agencies that it will reduce its net debt of $25.3 billion to $20 billion by the end of next year.

To raise the cash, AOL Time Warner is trying to sell its book publishing division; its Atlanta professional sports teams, including the Braves; and its CD and DVD manufacturing business. It also wants to sell a minority stake in its cable television division in an initial public offering. The $750 million payment from Microsoft is about twice as much as the book publishing division is expected to fetch, analysts said.

Wall Street applauded the legal settlement.

"I call it a major surprise," said John Tinker, an analyst at Blaylock & Partners. "These things can go on for years, and Microsoft in general is not known for paying, particularly in this kind of sum."
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