In Agreement With Microsoft, AOL Gets Cash and Flexibility

By SAUL HANSELL

AOL Time Warner and Microsoft presented the agreement they announced Thursday as a new era of cooperation between two longtime rivals. But on closer inspection, the terms of the deal largely require Microsoft to cooperate with AOL while inviting AOL to reciprocate at its pleasure.

That suggests that Microsoft is not gaining any particular advantage as it seeks to conquer new software markets related to the Internet, including instant messaging and digital distribution of audio and video programming.

The settlement of AOL’s antitrust suit against Microsoft does not in any way reduce the competition between the America Online division of AOL and the MSN operation of Microsoft, the two biggest Internet service providers. But it does promise to limit how much that rivalry will spill over to unrelated deals between Microsoft’s software operation and AOL’s media units, analysts and company executives said.

Beyond the $750 million it received to settle the case, AOL also retains some important flexibility. For example, Warner Music has been slow to consider whether to use Microsoft software to publish online versions of its catalog. The new deal does not commit AOL to use the Microsoft software, but AOL does promise to give Microsoft a fair hearing.

Over the last few years, both companies had reason to try to assemble as many bargaining chips as possible. AOL sued Microsoft last year on behalf of Netscape Communications, the browser company it bought in 1998. Because federal courts had ruled that Microsoft had illegally used its monopoly in operating systems to hurt Netscape, legal analysts thought that AOL probably had a valid claim, although predicting the amount of damages a court would award is difficult. There were also a number of other unsettled issues hanging over the companies.

Indeed, Microsoft seemed to hold the edge in past disputes between the two. In the summer of 2001, Microsoft, for example, had been in extensive negotiation before the release of Windows XP. Previous versions of Windows included a copy of the AOL software, making it easy for any Windows user to sign up for the service.

In return for putting AOL software in Windows XP, Microsoft presented a series of demands, including requirements that AOL abandon any legal claims against it, that AOL Time Warner use its media software, and that a link be created from AOL’s popular instant message system to Microsoft’s.

AOL wanted to be assured that Microsoft would not use its operating system and Internet Explorer browser to put it at a disadvantage relative to MSN. Despite its purchase of Netscape, AOL continued to use the Microsoft browser in its software.

First of all, Microsoft will pay AOL $750 million, welcome cash as AOL tries to reduce its debts. Second, Microsoft commits itself to licensing AOL its browser software free for seven years and selling it media software at favorable rates. This, and a promise by Microsoft to share information on its software, gives AOL the assurance it will not be put at a disadvantage. But it does not require AOL to use any particular Microsoft products.

To be sure, Microsoft eliminates the uncertainty about the size of any future antitrust judgment in favor of AOL. But beyond that, AOL did little more than agree to talk to Microsoft about cooperating on instant messaging and its media software.

Indeed, analysts said they expected AOL to keep its instant messaging system exclusive for as long as it can. Even though AOL gives away software to let anyone use its messaging system, instant messaging is a leading reason customers prefer America Online’s paid service.

"I.M. is the killer application," said Genelle Hung, an analyst with the Radicati Group, a research firm. "There is no other feature that keeps people coming back. It makes no business sense for them to make their system interoperable."

AOL has petitioned the F.C.C. to release it from rules that would force it to allow other instant message systems to connect to its own if it adds advanced features like video communications.

Investors in both companies seemed to warm to the deal. AOL’s shares rose 37 cents yesterday, to $15.22. Microsoft’s shares rose 21 cents, to $24.61.

For Microsoft, the deal also puts the final nail in the Netscape coffin.

AOL has been keeping Netscape alive, despite its tiny market share, largely as a bargaining chip with Microsoft. After Netscape’s latest release this summer, AOL is likely to cut even further the small group of people who remain devoted to Netscape’s software.

Even Netscape’s Web site, once the centerpiece of the effort to connect the online versions of all of AOL Time Warner’s media properties, is now being de-emphasized. The Web sites of its magazines, including Time and Fortune, are no longer presented under the Netscape banner. Rather, those magazines are increasingly being used to bolster the flagging fortunes of America Online’s main service.

In the end, though, little in the settlement Thursday does much to address America Online’s biggest problem: the defection of its customers to high-speed, or broadband, connections. MSN is suffering from much the same difficulty. And both are trying to refashion themselves as providers of extra-fee services to people with high-speed access.

"AOL and Microsoft," said Jed Kolko, an analyst with Forrester Research, "are both competing far more with broadband today than with each other."