

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

UNITED STATES OF AMERICA,

Plaintiff,

-against-

INTERNATIONAL BUSINESS MACHINES
CORPORATION,

Defendant.

Civil Action
No. 72-344 (AGS)

UNITED STATES' PRELIMINARY STATEMENT OF ISSUES

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I. INTRODUCTION

Pursuant to the Court's request at the June 19, 1995 hearing, the government respectfully submits this preliminary statement of the issues. We write this statement prior to the requisite discovery of the issues raised by the motion of International Business Machines Corporation ("IBM") to terminate the final judgment in this case (the "judgment" or "decree"), and thus will seek to modify or supplement our views should the need arise. The purpose of this statement is to set forth the legal and factual issues raised by the motion to terminate. Specifically, by this submission we wish to underscore that:

- (1) to satisfy its burden for obtaining unilateral termination of the judgment in its current application to any market, IBM must show that continuation of the judgment would be detrimental to the public interest in competition in that market. Accordingly, any assessment of the impact of termination can be made only in the context of an analysis of current market conditions, and any relief must be suitably tailored to the harm that IBM demonstrates;
- (2) by its own terms, the decree applies to electronic data processing (*viz.*, the computer industry) and IBM's emphasis on the complaint's focus on tabulating machines is misguided;
- (3) IBM's arguments and factual assertions in its various memoranda and in-court statements fail to provide for a meaningful competitive analysis of the likely effect of judgment termination and present an incomplete portrait of the circumstances leading up the decree;
- (4) despite IBM's failure to address the issues in a manner that allows for a meaningful competitive analysis of the effect of judgment termination, the government concurs that the judgment should be terminated to the extent that it no longer serves to promote the public interest in competition. Below, we identify the areas where tentatively we do not object to appropriate limitations on the judgment, subject to our having an opportunity to evaluate public comments. We also identify the areas as precisely as possible where our continuing investigation suggests that termination of the judgment could threaten the public interest in competition; and
- (5) we still need substantial information to reach a definitive position on the issues raised below and thus we propose a plan that will enable us to complete our investigation of the complex competitive issues posed by IBM's motion with the aid of the Court's discovery process.

II. BACKGROUND

At the outset, we note that on the basis of our inquiry to date and subject to our review of public comments, we will not oppose termination of decree Sections V(b)-(c)(which concerns IBM's obligations to offer to sell to used equipment dealers computers that it obtains in trade) and VIII (which creates standards for the operation of IBM's service bureau business). Moreover, we will not oppose termination of the remaining provisions of the decree insofar as they apply to products and services that are outside the System 360-390 or AS/400 families of products. Thus, we would not oppose termination insofar as the decree now applies to all of IBM's current PC computer products. We will not further address these judgment sections or products in this memorandum, but we note that IBM appears to base its termination motion primarily on arguments about the sections or products that we are willing to terminate.

The judgment was entered on January 25, 1956, four years after the government's complaint had charged that IBM engaged in longstanding monopolization and attempted monopolization and agreements in restraint of trade in the tabulating industry, in violation of Sherman Act sections 1, 2, 15 U.S.C §§ 1-2. (*Complaint* § IV, ¶ 45 (U.S. Selected Docs. tab 1)).¹ Many sections of the judgment were intended to be temporary and have terminated by their own terms. See IBM's Preliminary Statement of Issues (dated June 6, 1995) ("*IBM Prelim.*") at 26 n. 24. The remaining sections were intended to apply perpetually, and the judgment contains no express or implied provision for termination of those sections. Below, we describe those remaining provisions to which we have not consented to termination.

¹The complaint alleged that by 1934 IBM owned about 85 percent of all tabulating machines in the United States and that its market share continued to grow to 90 percent by the time the complaint was filed. (*Complaint* § III, ¶¶ 28-32.). It alleged that IBM achieved a dominating position by, among other ways, excluding potential competition in the manufacture of tabulating machines and preventing the development and growth of independent maintenance and repair businesses. (*Id.* § IV, ¶ 45.). The complaint alleged that IBM had excluded competition in many ways, including by systematically acquiring control over potential competitors (*id.* § IV, ¶ 47.b) or over developments, inventions and patents made or owned by others (*id.* § IV, ¶ 47.a) and operating its service bureaus to preempt any customer demand for competitors' products (*id.* § IV, ¶ 48.b.).

The judgment applies to all of IBM's computer hardware products and to its operating system software products that are necessary for operation of any particular computer or computer system, as provided in the definitions of "Electronic data processing system" (EDP system) and "Electronic data processing machine" (EDP machine or equipment) (*Decree* §§ II(e)-(f)).²

Section IV of the judgment enjoined IBM's longstanding lease-only policy.³ Among other things, it requires IBM to offer computers for sale at prices and on terms and conditions that are not substantially more advantageous to IBM than lease charges and that have a

The government disputes IBM's contention that the judgment does not apply to software. See IBM's Chronology of the 1956 Consent Decree (dated June 6, 1995) ("*IBM Chron.*") at 27. The definition of "EDP machine" in the judgment means machines or devices and *attachments* therefor used in or with an electronic data processing system. (*Decree* § II(f)). The definition of "EDP system" means any single working machine or group of intercommunicating machines that is affirmatively capable of performing the functions described in the definition, such as "entering, receiving, storing, classifying, computing, and/or recording alphabetic and/or numeric accounting and /or statistical data ..." (*Id.* § II(e)). However, as IBM concedes, "computers simply do not work without software." (*IBM Prelim.* at 21.). Certain types of software, including operating systems and perhaps some other systems software products, are necessary for computers to operate. See Stipulation ¶¶ 2, 22 (*IBM Chron.* tab 10). The fact that operating system software may have come into use after entry of the decree does not exempt it as an "attachment" for a machine that is used in or with a working EDP system. The government contends that the judgment covers IBM's operating system software products that are necessary for any particular computer or computer system to perform the functions specified in the definition of EDP system. The fact that operating system software is included within the decree does not mean that IBM cannot enforce its intellectual property rights in software. The government has recognized that the judgment should be read as limiting IBM's intellectual property rights "only when clearly necessary to give effect to the plain meaning of the decree language and the intent of the parties in drafting such language." (April 13, 1990 letter from James F. Rill to Robert G. Levy at 3 (U.S. Selected Docs. tab 17)).

The complaint alleged that IBM refused to sell its products and leased them pursuant to agreements requiring lessees to pay a single charge for rental, instructions on use and repair and maintenance (*Complaint* § IV, ¶ 50.a). IBM's leasing practices were alleged to have restrained competition in the repair and maintenance of tabulating machines and in the buying and selling of used tabulating machines (*id.* § IV, ¶ 51.a, c). IBM had agreed in 1931 with its only United States competitor in the tabulating industry that both firms would lease and not sell their products and that they would require customers to purchase their punch card requirements from the lessor or pay a higher rental (*id.* § III, ¶ 25). In 1932, the government charged that this agreement and that the provisions in leases requiring lessees to pay higher rental for their machines if they did not use cards purchased from the lessor violated the antitrust laws (*id.* § III, ¶ 27; March 26, 1932 Petition of the United States ¶¶ 23-24 (U.S. Selected Docs. tab 21)). In 1934, the issues relating to the agreement between IBM and its competitor were withdrawn from the case when the agreement was cancelled, and in 1936, the Supreme Court held that the IBM lease provisions which in effect required lessees of IBM machines to purchase cards from the IBM were illegal (1952 Complaint § III, ¶ 27. *United States v. IBM*, 298 U.S. 131, 135-36, 56 S. Ct. 701, 703-04 (1936)).

commercially reasonable relationship to the lease charges for such computers. (*Decree* §§ IV(a), (c)(2)).

Section V(a) enjoins IBM from acquiring used IBM computers owned by persons other than IBM except as a trade-in on the purchase of a new computer or as a credit against a debt owed to IBM. This section does not prohibit IBM from reacquiring possession to computers that it has been leasing to any customer.

Section VI prohibits IBM from discriminating against owners of computers in favor of lessees.⁴ Section VI(a) requires IBM to provide without separate charge the same type of services, except repair and maintenance, that it provides to lessees without separate charge. Section VI(b) generally requires IBM to provide at reasonable and nondiscriminatory prices and terms repair and maintenance services for computer owners. Section VI(c) requires IBM to sell computer repair and replacement parts and subassemblies at reasonable and nondiscriminatory prices to IBM computer owners and third party computer repair companies for as long as such parts are available for use in its leased machines.

Section VII(b) enjoins IBM from requiring any IBM computer lessee or purchaser to disclose the use of its computer. Section VII(c) enjoins IBM from requiring that any IBM computer purchaser obtain from IBM repair and maintenance or repair parts. Section VII(d)(2)-(3) restricts IBM from limiting the ability of IBM consumers to experiment with their computers or to make alterations in or attachments to those computers.⁵

The complaint alleged that IBM excluded competition by granting discriminatory price and service concessions only to certain of its machine licensees who were most likely to seek competitive alternatives (Complaint § IV, ¶ 48.a).

IBM's leases could be cancelled without notice if lessees used leased products for any purpose that was not approved in advance by IBM or if they experimented with the leased products (Complaint § IV, ¶ 50.b(U.S. Selected Docs. tab 1)). Lessees could not make attachments to or alterations in leased products without IBM's prior consent (*id.* § IV, ¶ 50.c). The complaint alleged that IBM had excluded competition by preventing or controlling experimental use of its machines so that it would obtain control over any inventions made by others as a result of such experimentation (*id.* § IV, ¶ 47.b (5)-(6)). The complaint also alleged that IBM's leasing practices restrained competition in attachments for tabulating machines and restrained competition generally in the

Section IX(b) requires IBM to provide at reasonable and nondiscriminatory charges to IBM computer owners, third party repair and maintenance firms and distributors the same technical informational documents that it provides generally to its own repair and maintenance employees. Section IX(c) requires IBM to provide on a nondiscriminatory basis and at reasonable charges to IBM computer lessees and purchasers manuals, books of instruction and other documents pertaining to the operation or application of their computers.

Section XV(a) enjoins IBM from participating in agreements with its competitors or potential competitors in the computer industry to allocate markets or restrain imports into the United States or exports from the United States.⁶ Section XV(b) prohibits IBM from conditioning the sale or lease of one computer product on the purchase or lease of any other computer product.

tabulating machine industry by requiring that potential competitors be prepared to enter the market with a full line of products required for use in a complete tabulating system (*id.* § IV, ¶ 51.d).

The complaint alleged that IBM had excluded competition by entering into territorial allocation agreements in which potential competitors agreed not to compete in the United States (Complaint § IV, ¶ 47.a(4), d).

III. AN INDEPENDENT PURPOSE OF THE JUDGMENT IS TO CONSTRAIN IBM'S EXERCISE OF MARKET POWER IN THE COMPUTER INDUSTRY

A. The Purpose Of The Decree Was To Terminate IBM's Monopoly And Prohibit Practices That Might Result In Monopolization

Although the complaint alleged that IBM had obtained and maintained a longstanding monopoly through a wide variety of exclusionary practices and anticompetitive agreements, the consent decree did not rely primarily on divestiture to disgorge IBM of its ill-gotten gains, restore competition and eliminate the threat of any future anticompetitive conduct. Nor did the decree prevent IBM from participating in other related businesses.⁷ Rather, it sought to encourage competition with provisions that constrain IBM's ability to exercise market power. Much of the judgment was patterned on the decree entered by Judge Wyzanski in *United States v. United Shoe Machinery Corp.*, 110 F. Supp. 295 (D. Mass. 1953), *aff'd per curiam*, 347 U.S. 521, 745 S. Ct. 699 (1954); *see also Allen-Myland, Inc. v. IBM*, 746 F. Supp. 520, 547 (E.D. Pa 1990), *vacated in part on other grounds*, 33 F.3d 194 (3d Cir.), *cert. denied*, 115 S. Ct. 684 (1994); July 20, 1955 tr. at 22 (U.S. Selected Docs. tab 8); May 5, 1960 letter from Robert A Bicks to Murray A. Reiter (U.S. Selected Docs. tab 16).⁸

The fact that the consent decree did not enjoin IBM from participation in the EDP industry totally distinguishes this case from the cases that IBM cites for the proposition that courts do not consider the effect of decree termination on markets that were not the focus of the allegations in the complaint. (*IBM Prelim.* at 8-9.). *See United States v. National Broadcasting Co.*, 842 F. Supp. 402 (C.D. 1993); *United States v. Swift & Co.*, 1975-1 Trade Cas. ¶ 60,201 (N.D. Ill. 1975). In both of those cases, the Courts focused their analyses of current market conditions on the markets in which the defendants participated. It would have made no sense for the Courts to assess the defendants' market power in markets from which the decrees had barred their participation. In contrast, an analysis of current market conditions to assess the likely impact of judgment termination in the computer industry is necessary in this case because IBM participates in that industry subject to the requirements in the judgment.

⁸ Judge Wyzanski explained in *United Shoe Machinery Corp.*, which was a litigated monopolization case: "Where a defendant has monopolized commerce in violation of Sec. 2 [15 U.S.C. § 2], the principal objects of the decrees are to extirpate practices that have caused or may hereafter cause monopolization, and to restore workable competition in the market." 110 F. Supp. at 346-47. The Supreme Court subsequently specifically endorsed Judge Wyzanski's view as to the purpose of a decree in a litigated monopolization case and further clarified that the Court in such a case should prescribe relief that will "terminate the illegal monopoly, deny the defendant the fruits of its statutory violation,

B. The Judgment Has Consistently Applied Unambiguously And Independently To IBM's Conduct In The Computer Industry

IBM's suggestion that the continued viability of the judgment to the computer industry must be assessed in connection with its position (or lack of position) in the tabulating industry is an effort to rewrite the bargain to which it consented. The decree provisions that remain in effect today apply unambiguously to constrain its exercise of market power in the computer industry, as IBM concedes. (*IBM Chron.* at 27.). IBM would search in vain for any language in the judgment suggesting even faintly that the decline of the tabulating industry and IBM's position in it should or could support decree termination without regard to current market conditions in the computer industry.

IBM's argument that the "continuing viability of the 1956 IBM Consent Decree must be evaluated solely on the basis of the conduct and the market alleged in the 1952 complaint," (*IBM Prelim.* at 8), ignores the Supreme Court's admonition that the purposes of a consent decree must be determined by "the purposes of the litigation *as incorporated in the decree*" *United Shoe*, 391 U.S. at 248, 88 S. Ct. at 1499 (emphasis added). The Supreme Court recognizes that consent decrees embody compromises in which parties waive their rights to litigate the issues and seek language that furthers their own, often opposing interests as reflected by their respective bargaining power and skill:

For these reasons, the scope of a consent decree must be discerned within its four corners, and not by reference to what might satisfy the purposes of one of the parties to it. Because the defendant has, by the decree, waived his right to litigate the issues raised, a right guaranteed to him by the Due Process Clause, the conditions upon which he has given that waiver must be respected, and the instrument must be construed as it is written, and not as it might have been written had the plaintiff established his factual claims and legal theories in litigation.

United States v. Armour & Co., 402 U.S. 672, 681-82, 91 S. Ct. 1752, 1757 (1971).

and ensure that there remain no practices likely to result in monopolization." *United States v. United Shoe Machinery Corp.*, 391 U.S. 244, 250, 88 S. Ct. 1496, 1500 (1968).

As to IBM's fixation on the complaint as the sole guide for determining the purpose of the judgment, we acknowledge that Courts may rely on conventional "aids to construction" in interpreting ambiguous consent decree provisions. *United States v. ITT Continental Baking Co.*, 420 U.S. 223, 238, 95 S. Ct. 926, 935 (1975). "Extrinsic evidence, however, may generally be considered only if the terms of the judgment, or of documents incorporated in it, are ambiguous." *SEC v. Levine*, 881 F. 2d 1165, 1179 (2d Cir. 1989); accord *United States v. O'Rourke*, 943 F. 2d 180, 187 (2d Cir. 1991)(quoting *Levine*, 881 F. 2d at 1179); *Western Elec. Co.*, 900 F. 2d at 306.

No "aids to construction" are necessary to determine the purpose of the judgment in this case because the decree unambiguously applies to EDP equipment and is in no way conditioned on IBM's continued participation in the tabulating industry. Moreover, consistent with the unambiguous purpose of the judgment, as stated in the four corners of the document, IBM continues to acknowledge that, after nearly forty years, the decree continues to constrain its behavior in the computer industry. (*IBM Chron.* at 27.). The consistent longstanding application of the judgment to computers without regard to IBM's position in the tabulating industry (which IBM exited many years ago) refutes IBM's argument at this late date that the decree's continuing viability in the computer industry is now linked to the IBM's position in the tabulating industry. See *United States v. Atlantic Refining Co.*, 360 U.S. 19, 23-24, 79 S. Ct. 944 946-47 (1959)(where language of consent decree supports longstanding interpretation supported over many years by the parties' conduct and intended by the parties, the interpretation will not be changed because another reading might seem more consistent with the government's reasons for entering into the decree).

C. The Parties' Contemporaneous Statements And The Circumstances Of The Judgment Negotiations Confirm That The Decree Applies Independently To Computers

Even if the judgment were ambiguous in its application to EDP equipment independent of IBM's position in the tabulating machine industry, which it is not, IBM is wrong in contending

that the purpose and continuing viability of the decree must be evaluated solely or even primarily on the basis of conduct alleged in the complaint. (*IBM Prelim.* at 5, 8, 14-15.).⁹ Instead, as the Second Circuit has made clear, "when the language of a consent decree provision is not clear on its face, a court of equity may, in construing the provision, consider the purpose of the provision in the overall context of the judgment *at the time the judgment was entered.*" *United States v. American Cyanamid Co.*, 719 F. 2d 558, 564 (2d Cir. 1983), *cert. denied sub nom. American Cyanamid Co. v. Melamine Chemicals, Inc.*, 465 U.S. 1101, 104 S. Ct. 1596 (1984) (emphasis supplied). When the purpose of a decree provision is ambiguous, the Court should first seek interpretative assistance from ""contemporaneous statements of [the decree's] objectives."" *United States v. Western Elec. Co.*, 900 F. 2d 283, 306 (D.C. Cir.), *cert. denied sub nom. MCI Communications Corp. v. United States*, 498 U.S. 911, 111 S. Ct. 283 (1990)(quoting *United States v. Western Elec. Co.*, 894 F. 2d 1387, 1391 (D.C. Cir. 1990) and *United States v. Western Elec. Co.*, 846 F. 2d 1422, 1427 (D.C. Cir.), *cert. denied*, U.S. , 109 S. Ct. 306 (1988); *see also ITT Continental Baking Co.*, 420 U.S. at 238, 95 S. Ct. at 935 (interpretative aids include "the circumstances surrounding the formation of the consent order, any technical meaning words used may have had to the parties, and any other documents expressly incorporated in the decree").

IBM's reliance on *United States v. Microsoft Corp.*, No. 95-5037 (D.C. Cir., June 16, 1995) and the Tunney Act, 15 U.S.C. § 16(b)-(h), provide no support for its argument that the continuing viability of a consent decree must be evaluated solely on the basis of the conduct and market alleged in the complaint in a proceeding in which the government has not yet consented to termination. (*IBM Prelim.* 8). The Tunney Act specifies the criteria that a Court may consider when determining whether the initial entry of a consent decree is in the public interest. *Id.* § 16(e). In *Microsoft*, the Court of Appeals held that, in the absence of a showing of bad faith on the part of the government, the Tunney Act does not allow a Court to assume the role of Attorney General and reach beyond the allegations in the complaint in assessing the adequacy of relief in a consent decree. Slip op. at 23-24, 32. The Court of Appeals emphasized that a District Court's review in a Tunney Act proceeding must be even more deferential than the limited review that a Court undertakes when the government consents to a proposed decree modification. *Id.* at 26-27. The Second Circuit has held that the Tunney Act applies only to the entry of a consent decree and not to decree modification or termination proceedings. *American Cyanamid Co.*, 719 F. 2d at 565 n.7; *In re IBM*, 687 F. 2d 591, 601 (2d Cir. 1982). Moreover, the deferential standard of review that the Court imposed in *Microsoft* was founded on the government's consent to the decree. A similar standard of review in this case would be appropriate only as to those portions of IBM's motion with which the government concurs.

To be sure, the complaint identifies the alleged statutory violations and the government's theory of competitive harm, which helps to shape a Court's review of a motion to terminate a decree. *American Cyanamid Co.*, 719 F. 2d at 565-66. However, the law's focus on contemporaneous statements of the decree's objectives is particularly appropriate in this case because four years passed between the filing of the complaint and the entry of the judgment. Contemporaneous statements made by the parties to the Court, the public and each other provide no support for the conclusion that the final judgment's continuing application to computers would be linked in any way to IBM's position in the tabulating industry. Rather, the government explained to the Court that, because the industry was dynamic, the parties agreed to include EDP equipment within the scope of the judgment. (January 25, 1956 tr. at 58-59 (U.S. Selected Docs. tab 11)). Moreover, the government's stated concern that failure to include EDP equipment would make "the decree obsolete before it is operative," (September 23, 1955 tr. at 4 (U.S. Selected Docs. tab 9)), refutes any contention that the viability of the judgment was intended to be linked to the tabulating industry.

Documents IBM includes as attachments to IBM's Chronology of the 1956 Consent Decree make clear that the government had received information to support its concern that failure to include EDP equipment within the judgment could make the decree obsolete. Thus, although IBM chides the government for seeking information from industry participants, (*IBM Chron.* at 17), the government obtained information indicating that IBM already was merchandising computers with the same "tactics which gave it a monopoly in the tabulating field, ... and may be seeking a monopoly position in its new field." March 30, 1955 Wehrmann mem. at 5 (*IBM Chron.* tab 28). Information suggested that computers would completely change the nature of the punch card business and that IBM was already using its entrenched position in the tabulating industry to monopolize electronic computing systems. April 15, 1955 Prezis mem. at 11-12 (*IBM Chron.* tab 29); May 12, 1955 Prezis mem. at 2 (*IBM Chron.* tab 30); January 21

1956 letter to Marcus A. Hollabaugh at 2, 5 (*IBM Chron.* tab 34); May 3, 1955 Bronaugh mem. at 2 (*IBM Chron.* tab 31)(statement attributed to T.J. Watson, Jr., President of IBM that "within five years, there would be no card operated accounting machines in use"). Indeed, it was alleged that IBM was one of only two suppliers of computers used for commercial purposes. June 17, 1955 Jones mem. at 3 (*IBM Chron.* tab 32). In 1955, IBM was alleged to be by far the largest supplier of EDP equipment, and in particular the largest supplier of medium sized EDP equipment, having installed or had on order 1,117 machines, in comparison to 31 installations or orders for its main competitor. January 21, 1956 letter to Marcus A. Hollabaugh at 1-2 (*IBM Chron.* tab 32).

This information regarding IBM's rise to dominance in the computer industry has been echoed by Thomas J. Watson, Jr., former President and Chief Executive Officer of IBM:

By the spring of 1954, IBM and UNIVAC [Remington Rand] were running a close horse race....

...

In a little over a year [summer 1955] we started delivering those redesigned computers. They made the UNIVAC obsolete and we soon left Remington Rand in the dust. By the time the presidential elections rolled around in 1956, we had eighty-seven machines in operation and one hundred ninety on order, against forty-one in operation and forty on order for all other computer-makers.

T.J. Watson, Jr., and P. Petre, Father Son & Co. My Life at IBM and Beyond, 242-43 (1990)

(attached at tab ____). Mr. Watson also explained how IBM was able to place its 650 computer, which was introduced in 1954, with tabulating machine users:

Over the next several years it enabled us to bring thousands of punch-card customers into the computer age. The 650 rented for about four thousand dollars a month, and was the perfect choice for companies eager to try computing because we designed it to work along with ordinary punch-card equipment. ... While our giant, million-dollar 700 series machines got the publicity, the 650 became computing's Model T.

Id. at 244. Another commentator has elaborated on why the success of the 650 was built in part on IBM's 90 percent market share of the tabulating machine market: IBM's tabulating machine customers already had large quantities of information coded on

punched cards and formalized procedures for processing it. Consequently, it was relatively easy to sell these customers an IBM 650, which could be viewed as an extremely fast and versatile tabulating machine that could read their existing cards.

G.W. Brock, The U.S. Computer Industry A Study of Market Power, 12 (1975).

By 1956, the computer industry had become an important capital market. The total retail value of computers installed in 1956 exceeded \$269 million, and IBM's share of the market was 75.3 percent, up from 56.1 percent in 1955. *Id.* at 13. IBM had already overcome Remington Rand's early lead, and its lead was increasing rapidly. *Id.* Remington Rand lacked IBM's large base of tabulating machine customers to provide easy upgrades, and "[d]uring 1956, IBM shipped 85.2 percent of the value of new systems, and Remington Rand only 9.7 percent--approximately the same relative shares as then existed in the tabulating machine market." *Id.*

The government may have had incomplete information about IBM's future position in the EDP industry, but it had sufficient competitive concerns about IBM's conduct in that industry to determine early in the judgment negotiations to seek relief that would enjoin IBM's lease only policy for all products and require it to sell computers. (April 26, 1955 Hollabaugh mem at 1 (*IBM Chron.* tab 39)).

In fact, although the complaint alleged violations in the tabulating industry, the parties negotiated the judgment with the specific understanding that the government might amend the complaint to include the EDP industry or seek relief after trial sufficiently broad to cover the EDP industry even if the complaint were not amended. (July 6, 1955 Jones and Reich mem. at 2 (*IBM Chron.* tab 47); May 9, 1955 mem. at 1 (*IBM Chron.* tab. 40)). These facts are revealing because, as the Second Circuit has observed, consent decrees are "motivated by *threatened* or pending litigation," *American Cyanamid Co.*, 719 F. 2d at 563(emphasis supplied), and, as IBM concedes, (*IBM Prelim.* at 6), Courts may impose on nonconsenting defendants in litigated antitrust cases relief that goes beyond the specific acts alleged in the complaint. *See*

National Soc'y of Professional Eng'rs v. United States, 435 U.S. 679, 697, S. Ct. , (1978)(antitrust decree in litigated case should "avoid recurrence of the violation and ... eliminate its consequences)¹⁰; *International Salt Co. v. United States*, 332 U.S. 392, 400-01, 68 S. Ct. 12, 17 (1947) (rejecting the argument that in litigated antitrust case "the injunction should go no farther than the violation or threat of violation").¹¹

As IBM concedes, the parties negotiated for months over the terms of the judgment and how it would apply to EDP equipment. IBM Chron at 17-25. IBM initially sought to exclude all EDP equipment from the scope of the judgment. IBM Chron. at 17. Ultimately, however, it agreed to include all of its EDP equipment within the scope of the judgment, IBM Chron. at 27 & n.27; January 25, 1956 letter from Thomas J. Watson, Jr. to the Attorney General (IBM Chron. tab 60). It focused instead on negotiating limitations on the length of various provisions and the way specific provisions would apply to EDP equipment. June 20, 1955 tr. at 24-26 (U.S. Selected Docs. tab 8); September 23, 1955 tr. at 3-5 (U.S. Selected Docs. tab 9); November 30, 1955 tr. at 33-35, 45 (U.S. Selected Docs. tab 10); January 25, 1956 tr. at 59-60, 85-89 (U.S. Selected Docs. tab 11). To this end, expiration dates for various provisions were specifically negotiated. (*IBM Chron.* 26 n.24.). The Judgment's patent licensing provisions allowed IBM,

IBM incorrectly implies that *National Soc'y of Professional Eng'rs* addressed a Court's ability to accept relief in consent decrees. IBM PSI at 6. Rather, the Supreme Court discussed the scope of relief that a Court could impose on nonconsenting defendants who filed timely objections in litigated cases. 435 U.S. at 685-86, 696-97, S.Ct. at , . The case therefore does not specify any limit to what a defendant may agree in a consent decree.

As IBM concedes, it consented to be enjoined from engaging in the same type of conduct in the EDP industry that the judgment prohibited in the tabulating industry. (*IBM Prelim.* at 15, *IBM Chron.* at 24.). Thus, the relief imposed by the decree is within the range of what the Court might have imposed even without IBM's consent if the case had proceeded to trial. The Supreme Court has made clear that in a litigated case involving a nonconsenting defendant, a "federal court has broad power to restrain acts which are of the same type or class as unlawful acts which the court has found to have been committed or whose commission in the future unless enjoined, may fairly be anticipated from the defendant's conduct in the past." *Zenith Radio Corp. v. Hazeltine Research, Inc.*, 395 U.S. 100, 132, 89 S. Ct. 1562, 1581(1969) (citations & internal quotation marks omitted).

as conditions to the licenses it granted under patents relating to tabulating machines and EDP equipment but not for licenses under existing patents relating to tabulating cards or card machinery, to charge royalties and obtain immunity from suit or cross licenses under the licensees' patents. (*Decree* § XI(d)(2), (g)). And IBM was required to provide manufacturing information relating to tabulating equipment, cards and card machinery but not for EDP equipment. (*Id.* § XIV.).

Both parties acknowledged in contemporaneous statements that the provisions of the judgment that continue in effect today were specifically intended to apply in perpetuity. January 25, 1956 Department of Justice Press Release at 1 (*IBM Chron.* tab 56); June 6, 1955 tr. at 22 (U.S. Selected Docs. tab 8)(IBM counsel explaining to the Court that negotiations were difficult because "the decree looks into eternity"). Like the judgment, neither the government's press release announcing the decree (*IBM Chron.* tab 56) nor the transcript of the parties' lengthy explanation of the judgment to the Court (U.S. Selected Docs. tab 11) contains any statement indicating that the decree obligations pertaining to the EDP industry were in any way linked to IBM's continuing position in the tabulating industry.

Under these circumstances, IBM's speculation about weaknesses in the government's case, as perceived by IBM or suggested by the internal deliberations of individual government employees, is irrelevant to any assessment of the meaning or purpose of otherwise unambiguous provisions in the judgment. (*IBM Prelim.* at 5; *IBM Chron.* at 23-24.). There is no evidence to suggest that the government ever conceded that the relief it sought was too broad or could not be obtained as a result of litigation.¹² IBM could have tested the strength of the government's case by proceeding to trial or seeking a different bargain during the negotiations. It could have

As to IBM's reliance on internal opinions discussed by individual government employees, the Second Circuit has indicated that such material has little or no evidentiary value. *Cf. United States v. Siemens Corp.*, 621 F. 2d 499, 508 (2d Cir. 1980) ("opinions of lower level employees without management responsibility, absent some indication that the senior management has seriously considered and endorsed those views, simply do not constitute evidence of corporate intent or commitment").

continued to oppose any application of the judgment to computers or it could have sought additional limitations on the judgment's application to EDP equipment, such as a provision, like the decree interpretation it is now urging on the Court, linking the continued viability of the judgment's application to computers to IBM's position in the tabulating industry. During the months of bargaining over the consent decree, it surrendered its position on these issues, and having consented to the decree, it is bound by the judgment's provisions and has waived its right to challenge whether the government's evidence in the case would have supported the same relief now contained in the judgment after trial. *Armour*, 402 U.S. at 681-82, 91 S. Ct. at 1757.¹³

IV. IBM HAS THE BURDEN OF PROVING THAT CONTINUATION OF THE JUDGMENT WOULD BE DETRIMENTAL TO THE PUBLIC INTEREST IN COMPETITION

A. The Public Interest Requires That The Judgment Not Be Terminated Until Its Purposes Have Been Fully Achieved

This Court has jurisdiction to modify or terminate the judgment pursuant to Section XIX of the judgment, Rules 60(b)(5) and (6) of the Federal Rules of Civil Procedure, and "principles inherent in the jurisdiction of the chancery." *United States v. Swift & Co.*, 286 U.S. 106, 114 (1932). *See United States v. Loew's Inc.*, 783 F. Supp. 211, 213 (S.D.N.Y. 1992).

The negotiations were not one-sided. The consent decree allowed IBM to avoid admission of liability, (*see* Judgment preamble), and escape the risk of an adverse adjudication at trial, which would have served as prima facie evidence of liability in follow-on treble damage actions brought by private plaintiffs under 15 U.S.C. § 4(a). *See* 15 U.S.C. § 16. IBM also avoided proof at trial that it had violated the antitrust judgment entered against it in 1935 (U.S. Selected Docs. tab 22). *See* November 30, 1955 tr. at 41 (U.S. Selected Docs. tab 10). More importantly, the government made a number of concessions as IBM concedes. (*IBM Chron.* at 20-25.). In return for perpetual provisions constraining IBM's ability to exercise market power, the government abandoned its right to seek more drastic relief, such as divestiture. (*See* Complaint § VI, ¶ 12); *cf. United Shoe*, 391 U.S. at 250-52, 88 S. Ct. at 1500-01 (in monopolization case, Court must prescribe relief, which can include divestiture, that will terminate monopoly, deny defendant fruits of violation, and ensure no future violation).

Almost 20 years after the judgment was entered, the government adopted a policy of limiting most, but not all, consent decrees to 10 years. If that policy had been in effect in the 1950's and if this case had been designated as an appropriate candidate for a 10-year decree, the government may have approached the negotiations differently and sought relief that would have terminated IBM's market power, and not merely constrained its ability to exercise such power. As such, the subsequent adoption of the 10-year policy is not relevant to the issue of whether the judgment in this case should be terminated.

Subject to consideration of public comment, the government will consent to terminate certain provisions of the judgment and to limit the scope of other provisions. However, IBM's proposal to terminate the judgment in its entirety raises competitive concerns in some segments of the computer industry, and we will oppose IBM's motion to the extent that termination would harm the public interest in competition in any market.

Regardless of the government's ultimate position on the motion, the Court should focus its review of IBM's motion on whether the purpose of the judgment has been achieved such that continuation of "the decree without modification would be detrimental to the public interest." *Rufo v. Inmates of the Suffolk County Jail*, 502 U. S. 367, 384, 112 S. Ct. 748, 760 (1992). The words "public interest" "take meaning from the purposes of the regulatory legislation." *NAACP v. FPC*, 425 U.S. 662, 669, 96 S. Ct. 1806, 1811 (1976); *see also System Federation No. 91 v. Wright*, 364 U.S. 642, 651, 81 S. Ct. 368, 373 (1961); *American Cyanamid Co.*, 719 F. 2d at 565.

In this case, the Sherman Act is the underlying statute, and "the policy unequivocally laid down by [that] Act is competition." *Northern Pacific Railway v. United States*, 356 U.S. 1, 4, 78 S. Ct. 514, 517 (1958); *see also United States v. Penn-Olin Chemical Co.*, 378 U.S. 158, 170, S. Ct. , (1964); *Brown Shoe Co. v. United States*, 370 U.S. 294, 320, 82 S. Ct. 1502, 1521 (1961); *American Cyanamid Co.*, 719 F. 2d at 565. "Thus, the ultimate question before the Court is whether termination of the Final Judgment would serve the public interest in 'free and unfettered competition as the rule of trade.'" *United States v. Columbia Artists Management, Inc.*, 662 F. Supp. 865, 870 (S.D.N.Y. 1987)(quoting *Northern Pacific Railway*, 356 U.S. at 4, 78 S. Ct. at 517; *see also Western Elec. Co.*, 900 F. 2d at 308; *Loew's Inc.*, 211 F. Supp. at 213.

The Supreme Court held in *Rufo* that a party seeking modification of a consent decree entered in institutional reform litigation "must establish that a significant change in facts or law warrants revision of the decree and that the proposed modification is suitably tailored to the

changed circumstance." 502 U.S. at 383, 112 S. Ct. at 765.¹⁴ IBM has sought to support its motion on the basis of changes in the facts. (*IBM Prelim.* at 4.).¹⁵ The Court in *Rufo* held that decree modifications may be warranted because of changes in factual conditions that (1) "make compliance with the decree substantially more onerous," (2) make the decree "unworkable because of unforeseen obstacles" or (3) make "enforcement of the decree without modification ... detrimental to the public interest" 502 U.S. at 384, 112 S. Ct. at 760.

Although IBM makes the tautological argument that compliance with the judgment is costly, it has made no showing that compliance has become substantially more onerous or that the judgment has become unworkable due to unforeseen obstacles.¹⁶ Thus, under *Rufo*, to

IBM apparently views as significant to this case, (*see IBM Prelim.* at 3 n. 2), the Supreme Court's unremarkable rejection of the very demanding standard for judgment termination, which would require "a clear showing of grievous wrong evoked by new and unforeseen conditions," enunciated by the Court in *United States v. Swift & Co.*, 286 U.S. 106, 119 (1932). *Rufo*, 502 U.S. at 379, 112 S. Ct. at 757. However, twenty-four years before *Rufo*, the Court in an antitrust case had already explained that the standard in *Swift* must be considered in the context of that case and was not intended for rote application in every case. *United Shoe*, 391 U.S. at 248, 88 S. Ct. at 1499. *See also Board of Education v. Dowell*, 498 U.S. 237, 246-47, 111 S. Ct. 630, 636-37(1991)(rejecting application of the *Swift* decree termination standard in a school desegregation case, relying on *United Shoe*). The Second Circuit, relying on *United Shoe*, similarly long ago recognized that *Swift* must be read in the context of its facts. *New York State Ass'n for Retarded Children, Inc. v. Carey*, 706 F. 2d 956, 968-69 (2d Cir.) (Friendly, J.), *cert. denied*, 464 U.S. 915, 104 S. Ct. 277 (1983); *King-Seeley Thermos Co. v. Aladdin Industries, Inc.*, 418 F. 2d 31, 34-35 (2d Cir. 1969). Indeed, the Supreme Court in *Rufo* relied on the flexible decree modification standard discussed by Judge Friendly in *New York State Ass's for Retarded Children*, 706 F. 2d at 967-71, in concluding that courts should exercise flexibility in considering requests for modification of institutional reform consent decrees. 502 U.S. at 379-83, 112 S. Ct. at 757-60.

IBM also has suggested that its motion may be justified because of unspecified changes in the law that it plans to discuss in a separate submission at some unspecified future time. (*IBM Prelim.* at 4 n. 3.). Because of IBM's lack of specificity, we cannot yet respond to its claims that the law has changed. However, the relevance of IBM's argument, without supporting facts applicable to this case, that it has become "widely accepted that the antitrust laws should not be used to deprive consumers of the efficiency benefits of vertical integration," *id.*, may be undermined by the Second Circuit's reversal of the District Court's decision to terminate a portion of the judgment on the basis of "contemporary economic theory" and without appropriate findings of fact based on "record data" in *American Cyanamid Co.*, 719 F. 2d at 566-67. We also note, and discuss below, that some recent clarifications in antitrust law, such as the Supreme Court's decision in *Eastman Kodak Co. v. Image Technical Servs., Inc.*, 112 S. Ct. 2072 (1992), have served to heighten our concern as to whether judgment termination would threaten the public interest in competition.

Even if IBM were to argue that compliance has become substantially more onerous, we would contend that the Court would give appropriate consideration to any such allegation in considering whether continuation of the

obtain termination of the judgment based on changes in facts, IBM has the burden of proving that enforcement of the decree without modification would be detrimental to the public interest in competition and that any change in the judgment is suitably tailored to the changed circumstances.

The decree modification standard in *Rufo* was presented in the context of institutional reform litigation. The Court emphasized "that a flexible approach is often essential to achieving the goals of reform litigation." 502 U.S. at 381, 112 S. Ct. at 758. Since the same factors are not applicable to antitrust consent decrees that were intended to operate in perpetuity, *Dowell*, 498 U.S. at 248, 111 S. Ct. at 637, the Court's analysis in *Rufo* is not particularly helpful in showing when changed circumstances would make continuation of an antitrust consent decree detrimental to the public interest.¹⁷ The Supreme Court, however, already has addressed this issue and has made clear that an antitrust consent decree "may *not* be changed in the interest of the defendants if the purposes of the litigation as incorporated in the decree (the elimination of monopoly and restrictive practices) have not been fully achieved." *United Shoe*, 391 U.S. at 248, 88 S. Ct. at 1499.¹⁸

judgment would be detrimental to the public interest in competition. As we explain below, in the antitrust context, to determine whether a consent decree continues to serve the public interest, the possible benefits of the judgment should be weighed against its costs, including the costs of compliance. If the costs exceed the foreseeable benefits, then the judgment would no longer serve the public interest in competition. In antitrust cases, the public interest review therefore provides a built-in standard for determining whether compliance with a judgment has become too onerous.

A forthcoming decision from the Second Circuit may provide better guidance on the application of *Rufo* to antitrust decree modification proceedings. *United States v. Eastman Kodak Co.*, 853 F. Supp. 1454 (W.D.N.Y. 1994), *appeal docketed*, No 94-6190 (2d Cir., July 18, 1994).

See also Dowell, 498 U.S. at 247, 111 S. Ct. at 636-37 (decree in school desegregation case could be terminated if purposes of the litigation had been "fully achieved," relying on *United Shoe*); *Patterson v. Newspaper & Mail Deliverers' Union* 13 F. 3d 33, 39 (2d Cir. 1993)(appropriate for court of equity to terminate decree in civil rights case once its objective has been reached, relying on *Rufo*, *Dowell* and *United Shoe*, *id.* at 37-38), *cert. denied*, 115 S. Ct. 58 (1994); *Still's Pharmacy, Inc. v. Cuomo*, 981 F.2d 632, 639-40 (2d Cir. 1992)(affirming District Court's denial of State's motion to add a sunset clause to settlement order in a Medicaid reimbursement case and inviting State to move to dissolve order when the wrong it "was drafted to cure no longer exists ...").

Any assessment of an antitrust judgment's continued contribution to the public interest in competition should therefore focus on whether the facts have changed sufficiently to achieve fully the purposes of the litigation as incorporated in the decree.¹⁹ In this case, if the judgment continues to promote competition in any market to which it applies, then the circumstances will not have changed sufficiently to achieve the purpose of the litigation in that market. If continuation of the judgment would harm the public interest in competition in any market, then circumstances will have changed sufficiently to achieve the purpose of the litigation in that market and retention of the judgment in that market would serve only to impose unnecessary costs.

B. If The Government Consents To Termination Or Modification, The Court's Public Interest Review Is Limited To Whether The Government Has Offered A Reasoned And Reasonable Explanation For Its Consent

As we explained in the Consolidated Reply of the United States to Proposed Intervenors' Responses to United States' Opposition to Motions to Intervene (U.S. Reply), at 6-7, the legal standard under which the Court considers IBM's motion will depend on the government's ultimate position on the motion. Where the government agrees that termination would serve the public interest, the Court's review of the motion should be limited to whether the government has

In cases applying *Rufo*, courts have focused on whether the purpose of the decree has been satisfied. See *Vanguards of Cleveland v. City of Cleveland*, 23 F.3d 1013, 1020 (6th Cir. 1994)(failure to achieve purposes warrants extending term of decree); *Inmates of Suffolk County Jail v. Rufo*, 12 F.3d 286, 293 (1st Cir. 1993)(minimum imaginable standards for decree termination include showing that "violations of the type that provoked the original action have been entirely remedied or remedied to the extent feasible"); *Patterson*, 13 F.3d at 39 (decree terminable when it "has served its purpose"); *United States v. City of Miami*, 2 F.3d 1497, 1508 (11th Cir. 1993)(decree terminable when its purpose has been fulfilled); *United States v. Agri-Mark, Inc.*, 156 F.R.D. 87, 88-89 (D. Vt. 1994)(decree terminated when divestiture eliminated threat to competition); *Eastman Kodak Co.*, 853 F. Supp. at 1487-88 (decrees ordered to be terminated on ground that purposes have been achieved and Kodak no longer has market power). Even before *Rufo*, the Second Circuit recognized that decrees could be modified to achieve their purpose. *New York State Ass'n for Retarded Children*, 706 F.2d at 969; *King-Seeley Thermos Co.*, 418 F.2d at 35; see also *United Shoe*, 391 U.S. at 252, 88 S. Ct. at 1501 (at request of government, court may modify antitrust decree to accomplish its intended result).

offered a reasoned and reasonable explanation of why the termination or modification vindicates the public interest in competition. *Loew's, Inc.*, 783 F. Supp. at 214; *Columbia Artists Management*, 662 F. Supp. at 870.

In government antitrust actions, the government represents the public interest in competition, *United States v. IBM*, No. 72-344 (AGS), slip. op. at 2 (S.D.N.Y., June 16, 1995), and the government has broad discretion in controlling and settling antitrust litigation on terms that will best serve the public interest in competition. *Sam Fox Publishing Co. v. United States*, 366 U.S. 683, 689, 81 S. Ct. 1309, 1313 (1961); *Loew's, Inc.*, 783 F. Supp. at 214.

Consequently, when the government consents to a proposed modification or termination, the role of the Court is not to substitute its opinion on the appropriate disposition of the case. *Id.*; *Columbia Artists Management*, 662 F. Supp. at 870; *see also United States v. Mid-America Dairymen, Inc.*, 1977-1 Trade Cas. (CCH) ¶ 61,508, at 71,980 (W.D. Mo. 1977) (in determining whether the initial entry of a consent decree is in the public interest, absent a showing that the government abused its discretion or failed to discharge its duty, Court's role is to determine the reasonableness of the government's explanation and not to substitute its opinion).

Rather, the Court's function is "only to confirm that the resulting 'settlement is 'within the reaches of the public interest.'" *Western Elec. Co.*, 900 F. 2d at 309 (quoting *United States v. Bechtel Corp.*, 648 F. 2d 660, 666 (9th Cir.), *cert. denied*, 454 U.S. 1083, 102 S. Ct. 638 (1981) (quoting *United States v. Gillette Co.*, 406 F. Supp. 713, 716 (D. Mass. 1975)). The Court should approve an uncontested modification "so long as the resulting array of rights and obligations is within the zone of settlements consonant with the public interest today." *Id.* at 307; *see also United States, v. Western Elec. Co.*, 993 F. 2d 1572, 1577 (D.C. Cir. 1993) ("court may reject an uncontested modification only if it has exceptional confidence that adverse antitrust consequences will result"), *cert. denied sub nom. Consumer Federation of America v. United States*, 114 S. Ct. 481 (1993).

C. If The Government Opposes Termination, IBM Must Demonstrate That Continuation Of The Judgment Would Be Detrimental To The Public Interest In Competition

If the government opposes termination of all or part of the judgment, the Court's inquiry is not limited to reviewing the reasonableness of IBM's proffered explanations in support of termination. Rather, as to any part of the judgment that the government seeks to retain, the Court must decide whether IBM has shown that continuation of the judgment would be detrimental to the public interest in competition in any affected market. *Western Elec. Co.*, 900 F. 2d at 308 (appropriate question is "whether the proposed modification would be certain to lessen competition in the relevant market")²⁰; *American Cyanamid Co.*, 719 F. 2d at 567 (reversal of District Court's decision to terminate antitrust decree on basis of "'contemporary economic theory'" and remand for District Court "to make findings of fact as to the current state of the melamine market and the market for products that contain melamine").²¹ As to any part of IBM's motion that the government does not yet have sufficient information to take a position on the merits, IBM must proceed at this time as if it is unilaterally seeking to terminate the judgment.

V. IBM CANNOT SATISFY ITS BURDEN WITHOUT THE REQUISITE MARKET ANALYSIS

In its Preliminary Statement of Issues, IBM declares that the decree causes "[h]arm to

In a subsequent decision, the District of Columbia Circuit explained that its focus in the passage quoted in the text was not on the word "certain" but on "the nature of the factors that fit within the 'public interest', which the court explained were antitrust considerations--the probable effects on competition within the relevant market." *Western Elec. Co.*, 993 F. 2d at 1576-77.

Unlike the judgment in this case, the decree in *American Cyanamid Co.* had a provision allowing the defendant to seek termination pursuant to a standard that tracked Section 7 of the Clayton Act, 15 U.S.C. § 18, one of the antitrust statutes at issue in that case. 719 F. 2d at 565. However, the Second Circuit recognized that "the 'public interest' derives meaning specifically from the Clayton Act, and so, the criteria used for determining a Clayton Act violation are applicable here for determining the 'public interest.'" *Id.* Accordingly, the Court concluded that the standards for decree termination established by the decree language and the public interest were identical. *Id.* at 565-66.

IBM and to Competition". (*IBM Prelim.* at 25.) (emphasis added).²² By distinguishing the harm the decree ostensibly imposes on IBM from the harm that allegedly befalls competition, IBM appears to agree that injury to competition is separate from and does not necessarily flow from harm to a competitor. In drawing this important distinction, IBM adheres to the command of the Supreme Court, which it cites in its Memorandum In Response To The Proposed Intervenor's May 11 Briefs (dated May 25, 1995) at 4, that "[t]he antitrust laws . . . were enacted for 'the protection of competition not competitors.'" *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477, 488 (1977) (appended to Defendant's May 25, 1995 brief).

In fact, in its Memorandum of Law In Response To SunGard And ACS's Motion to Intervene, IBM correctly identifies the question at issue but prematurely and conclusorily attempts to resolve it by stating that "SunGard and ACS's failure to identify any benefit to competition that allegedly results from the Decree not only merits that their motion be denied, but is further evidence that the Decree should be terminated. It is in fact their fear of the increased competition that termination of the Decree will bring that motivates SunGard and ACS's motion." IBM's Memorandum of Law In Response To SunGard And ACS's Motion to Intervene (dated January 13, 1995) at 4 (emphasis added). Whether, in fact, competition will increase or decrease absent the decree, is at the heart of this proceeding because, as IBM underscores, the ultimate protectable interest at stake is the "consumers' interest in competition". (IBM's Memorandum In Response To The Proposed Intervenor's May 11 Briefs (dated May 25, 1995) at 4.).²³

As the Second Circuit has noted in the rule of reason context: "[i]nsisting on proof of

²²(*See also IBM Prelim.* at 13.) ("IBM will demonstrate that the current operation of the Decree is detrimental to competition.")

²³*See Consolidated Reply of The United States to Proposed Intervenor's Responses To United States' Opposition To Motions To Intervene* (dated May 25, 1995) at 6; 8-9 ("*Consolidated Reply*") ("the government stands ready to oppose modification or termination that would *harm competition in any market.*") (emphasis added.)).

harm to the whole market fulfills the broad purpose of the antitrust law that was enacted to ensure competition in general, not narrowly focused to protect individual competitors." *Capital Imaging v. Mohawk Valley Medical Ass'n*, 996 F.2d 537, 543 (2d Cir.), *cert. denied*, 114 S. Ct. 388 (1993). Determining whether competition has been harmed in turn "requires a careful and complete analysis of the competitive effects of the challenged restraint." *Id.* So, too, the instant motion only can meaningfully be assessed within the context of a market analysis. The question, then, before the Court is whether and to what degree the public interest in competition will be served by retaining or by terminating the decree. But this question can only be resolved in the context of a market analysis; an analysis that IBM -- as the movant who bears the burden of proof -- seems reluctant to concur must be performed.²⁴

A. Market Definition Principles

To assess an injury to competition -- whether that injury stems from the decree itself, as IBM maintains or may arise from termination of the decree, a concern of the government -- the methodology is the same: relevant markets must be defined because "[w]ithout a definition of [the] market there is no way to measure [the defendant's] ability to lessen or destroy competition." *Spectrum Sports, Inc. v. McQuillan*, 113 S. Ct. 884, 890 (1993) (quoting *Walker Process Equip., Inc. v. Food Mach. & Chem. Corp.*, 382 U.S. 172, 177 (1965)). That is, ". . . the purpose of the inquiries into market definition and market power is to determine whether an arrangement has potential for genuine adverse effects on competition . . ." *F.T.C. v. Indiana*

²⁴ To the extent the decree imposes costs on IBM, those costs only are relevant in the context of a competitive analysis which assesses the effects of the decree on competition in properly defined markets. As noted above, the government tentatively has reached the decision not to oppose termination of Decree Section V(b)-(c) (requires IBM to offer to sell to equipment dealers used machines that it acquires in trade) and Decree Section VIII (restrictions on IBM's ability to operate service bureaus) and the remainder of the decree's provisions pertaining to electronic data processing machines and systems outside the System/360-390 or AS/400 families of products, including all of IBM's current personal computer products. For this reason, IBM's extensive comments on the decree's service bureau provisions, (*See IBM Prelim.* at 16; 18-19; 26.), and other discussion pertaining to products that are no longer the focus of our concerns, are irrelevant.

Federation of Dentists, 476 U.S. 447, 460 (1986). See also *Berkey Photo, Inc. v. Eastman Kodak Co.*, 603 F.2d 263, 268 (2d Cir. 1979) ("[i]t is, of course a basic principle in the law of monopolization that the first step in a court's analysis must be a definition of the relevant markets."), *cert. denied*, 444 U.S. 1093 (1980).²⁵

As a threshold matter, the Court must determine the relevant markets in which the IBM competes and ascertain whether IBM would possess market power or increased market power in any of those markets if the judgment were terminated. *Hayden Pub. Co. v. Cox Broadcasting Corp.*, 730 F.2d 64, 68 (2d Cir. 1984). A relevant market is comprised of those "commodities reasonably interchangeable by consumers for the same purposes", *United States v. E.I. Du Pont de Nemours & Co.*, 351 U.S. 377, 395 (1956), and "[i]n making this determination, the trier must decide whether the product is unique or has close substitutes, as to which there are substantial cross-elasticities of demand." *Fishman v. Estate of Wirtz*, 807 F.2d 520, 531 (7th Cir. 1986); *Hayden*, 730 F.2d at 70-71. And "[t]he product market must be plausibly defined according to the traditional 'methodology courts prescribe to define a market for antitrust purposes an analysis of the interchangeability of use or the cross-elasticity of demand for potential substitute products.'" *Rosen v. Hyundai Group (Korea)*, 829 F. Supp. 41, 47 (E.D.N.Y. 1993) (*quoting Gianna Enters. v. Miss World (Jersey) Ltd.*, 551 F. Supp. 1348, 1354 (S.D.N.Y. 1982)).²⁶

Because market definition is a prerequisite to determining whether competition is being injured, we are puzzled by the apparent *non sequitur* that "IBM should not be required to make a

²⁵See also *Gianna Enterprises v. Miss World (Jersey) Ltd.*, 551 F. Supp. 1348, 1354 (S.D.N.Y. 1982) ("[t]he absence of an adequate market definition makes it impossible even to approximate the market effect of defendants' allegedly anticompetitive agreement.") *Accord Apex Oil Co. v. DiMauro*, 713 F. Supp. 587, 595 (S.D.N.Y. 1989)("[t]he relevant market must first be defined and analyzed before examining the alleged anticompetitive effects.").

²⁶A relevant market also "consists of the geographic market -- the location in which a potential buyer may rationally seek specific goods or services." *Soap Opera Now, Inc. v. Network Publ. Corp.*, 737 F. Supp. 1338, 1344 (S.D.N.Y. 1990).

detailed presentation concerning the structure of the computer industry", (*id.*), even though IBM insists that the decree ". . . reduces the *competition* that the antitrust laws are designed to protect." (*Id.* at 2.) (emphasis added.). Apparently, IBM wishes merely to assert, but not demonstrate, the market definition predicate of a competitive analysis; in fact, the sole relevant market proffered by IBM thus far is the "worldwide information handling industry", (*see IBM Term. Mem.* at 9-10.). Plainly, this is an over-broad definition which cannot sustain IBM's burden to show that the public interest in competition warrants termination of the decree.²⁷

IBM bears the burden of establishing the markets that are subject to the public interest test and it must accept the consequences of erroneous market definition. We simply would repeat what we indicated in our Consolidated Reply at 8-9, that it is our experience in other investigations in the computer industry that the industry is not composed of one market, as IBM suggests, "but includes a wide array of interrelated markets for computer hardware, software and services." (*Id.* at 9.). Thus, without an adequate showing of market definition, the Court cannot be sure even in granting relief whether the decree is being modified to an extent *beyond the point* warranted by the changed circumstances, notwithstanding IBM's insistence that changed circumstances compels termination. *See Rufo*, 502 U.S. at 383, 112 S. Ct. at 760 ("a party seeking modification of a consent decree bears the burden of establishing that a significant change in circumstances warrants revision of the decree. If the moving party meets this standard, the court should consider whether the proposed modification is suitably tailored to the changed circumstance.") It surely proves too much to say that circumstances have changed since 1956 and that the decree should be terminated in its entirety. The government agrees that circumstances in the computer industry have changed but this tells us nothing about the relevant

²⁷As noted in its Consolidated Reply of The United States to Proposed Intervenor's Responses To United States' Opposition To Motions To Intervene (dated May 25, 1995) at 8-9 ("*Consolidated Reply*"), the Government submits that the "world-wide information handling industry", (*IBM Term. Mem.* at 9-10.), facially is an inadequate product market definition in which to assess IBM's market power.

markets that fall under the decree's definition of Electronic Data Processing Systems, nor whether IBM possesses market power in any of those markets and whether that power beneficially is constrained by the decree. This is the inquiry before us.²⁸

B. If IBM Has Market Power In Any Primary Market Or Aftermarket, The Court Must Assess Whether The Decree Constrains The Exercise Of That Market Power.

Once relevant markets have been defined in accordance with antitrust principles, the inquiry turns to whether judgment termination would enable IBM to possess market power or increased market power in any relevant market. *International Distribution Centers, Inc. v. Walsh Trucking Co.*, 812 F.2d 786, 791 (2d Cir.), *cert. denied*, 482 U.S. 915 (1987); *Hayden*, 730 F.2d at 68. Market power or monopoly power²⁹ can be defined as "the power to control prices or exclude competition." *Broadway Delivery Corp. v. United Parcel Service of America, Inc.*, 651 F.2d 122, 127 (2d Cir.), *cert. denied*, 454 U.S. 968 (1981). See *N.C.A.A. v. Board of Regents of Univ. of Oklahoma*, 468 U.S. 85, 109 n.38 (1984) ("[m]arket power is the ability to raise prices above those that would be charged in a competitive market.") (citations omitted). And "while market share is not the sole factor in the determination of market power, it is a highly significant one." *Delaware & Hudson R. Co. v. Consolidated Rail Corp.*, 902 F.2d 174, 179 (2d Cir. 1990). Under Second Circuit case law, a number of factors are relevant in determining whether monopoly power exists, including, "the strength of competition, the probable

The Court's review should determine whether termination of the judgment "would be anticompetitive under present market conditions." *Western Elec. Co.*, 900 F. 2d at 309; see also *American Cyanamid Co.*, 719 F. 2d at 567 (court must make findings of fact as to current state of market). This assessment will require, among other things, a determination of relevant markets, market shares, concentration of sellers and buyers in the market, capital cost required to enter the market and other barriers to entry, the minimum market share needed by a seller to achieve a profitable level of production and other scale economies, the degree of market power that IBM would possess if the judgment were terminated and the strength of competing suppliers and purchasers, and the likelihood and size of any market foreclosure resulting from judgment termination. See *id.* at 566-67 (discussing standard framework of analysis of vertical merger).

"Market power" is a synonym for "monopoly power". *International Dist. Centers, Inc. v. Walsh Trucking*, 812 F.2d 786, 791 n.3 (2d Cir. 1987) (citing *Broadway Delivery Corp. v. United Parcel Service, Inc.*, *supra*).

development of the industry, and consumer demand, as well as the percentage of market share enjoyed by the alleged monopolist". *Hayden*, 730 F.2d at 68-69. (reversing dismissal of monopolization claim).

Because the existence of market power generally is a question of fact, *Frito-Lay, Inc. v. Bachman Co.*, 659 F. Supp. 1129, 1139 (S.D.N.Y. 1986), IBM must demonstrate with facts that decree termination would not enable it to exercise market power in any relevant market falling within the scope of "[e]lectronic data processing system[s]" (*Final Judgment* § II(e).) and "[e]lectronic data processing machine[s]" (*Final Judgment* § II(f).)³⁰ To the extent that judgment termination would enable IBM to exercise or augment its market power -- as the Government suspects might be possible in the markets for System/390 mainframe or AS/400 mid-range computer products or services³¹ -- then IBM must show that the decree nevertheless is anticompetitive. As set forth below, if the decree *constrains the exercise* of IBM's market power in either a primary market (such as System/390 mainframes or operating systems) or aftermarket (such as the market for service and parts for System/390 mainframes), then IBM must show that the net competitive benefits of these constraints are outweighed by the net competitive costs.³² The concerns expressed below about IBM's market power are meant to be illustrative, not exhaustive, and should be considered within the context of consumers' expectations and past investments. Those investments likely took place with the expectation that competition in

³⁰See also *Virgin Atlantic Airways v. British Airways*, 872 F. Supp. 52, 63 (S.D.N.Y. 1994) (denying defendant's motion to dismiss monopoly leveraging claim because "such a ruling is only possible once all the facts have been developed, either on summary judgment or after trial").

³¹As we noted in the *Consolidated Reply* at 9, we are concerned that "IBM may possess substantial [market] power in the markets for hardware, replacement parts and/or operating systems for larger computers, especially mainframes."

³²This is because "the use of monopoly power, however lawfully acquired, to foreclose competition, to gain a competitive advantage, or to destroy a competitor, is unlawful." *Ortho Diagnostic Sys. v. Abbott Laboratories*, 822 F. Supp. 145, 153 (S.D.N.Y. 1993) (quoting *United States v. Griffith*, 334 U.S. 100, 107 (1948)).

primary and secondary markets would be at least robust as it is today. The discussion below, then, is meant to suggest to the Court only our preliminary concerns, providing the context for discovery.

1. IBM May Possess Market Power in the Market for System 390 Mainframes and Software.

Prima Facie evidence of IBM's market power is IBM's market share, which may account for between 70 to 80 per cent of all mainframes.³³ See *Allen-Myland v. International Bus. Mach. Corp.*, 33 F.3d 194, 201 (3d Cir.), *cert. denied*, 115 S. Ct. 684 (1994). IBM's market share of System/390 mainframes,³⁴ which we believe is a relevant market encompassing new machines that are compatible with IBM System/390 hardware and operating systems and used compatible machines, may be even higher than 80 percent. And from what we have been able to adduce so far, IBM is a monopolist in System/390 operating system software.³⁵ We believe the decree has spawned for consumers two sources of competitive alternatives in the primary market:

³³Market share is important to a market power inquiry because "[t]he existence of monopoly power 'ordinarily is inferred from the seller's possession of a predominant share of the market.'" *Caldwell v. American Basketball Ass'n, Inc.*, 825 F. Supp. 558, 575 (S.D.N.Y. 1993) (quoting *Eastman Kodak Co. v. Image Tech. Inc.*, ___ U.S. ___, 112 S. Ct. at 2081).

³⁴In this submission, the term "System/390" denotes IBM's current and predecessor generation of mainframe computers, ESA/390 (Enterprise System Architecture) and operating systems. The System/390 is a successor to the System/360 (which was introduced in the mid-1960s) and System/370 and IBM's operating systems provide for upward compatibility which allows a consumer to use software applications for an earlier system (such as the System/360) on later systems (such as the System/390). As IBM itself has noted, this obviously is of immense benefit to consumers who effectively are locked into the System/390 hardware and software; IBM's 1994 Annual Report states at page 10: "We also made sure that these advanced systems can run all existing System/390 software. That's no small consideration to customers who have invested more than \$1 trillion in large system software."

³⁵ The statement that IBM competes against a "large number of computer manufacturers" (*IBM Prelim.* at 23) is unifying because it fails to denote the product markets in which the listed companies compete and the extent to which (if any) they exert competitive pressures on IBM. For example, many of these companies appear to be personal computer manufactures, and, as noted, the Government tentatively does not oppose termination of the Decree as applied to personal computers.

manufacturers of compatible systems and vendors/lessors of used equipment (or "independents"). And, as explained below, we are concerned that termination of the decree could injure this competition.

Without the decree, IBM may have greater opportunities to exclude competing manufacturers of compatible Central Electronic Complexes ("CECs") as effective competitors.³⁶ By virtue of its monopoly control of System 390 operating systems, IBM is in a unique position to discriminate if it so chooses against competing manufacturers of compatible by denying them the important interface information they currently receive pursuant to decree sections IX(b)-(c) when they purchase IBM mainframes and upon which they rely consistent with decree section VII(d)(2) to ensure their CECs remain compatible with IBM's operating systems, the industry standard.³⁷ Exclusionary discrimination therefore could occur if IBM withholds in whole or in part important information relating to compatibility or resorts to its practice before the judgment was entered of restricting experimentation with that information by competitors.³⁸ To the extent that the decree's disclosure provisions allow for the existence of the competing CEC manufacturers, the decree is procompetitive because it guards against the risk those competitors

³⁶A System 390 mainframe is comprised of a number of hardware products. First, there is the CEC, which generally is comprised of at least one Central Processing Units (the "brains" of the system that often can execute more than 50 million instructions per second), main memory (the repository of electronic data, often with a capacity of hundreds of millions of characters) and channels (which are the CEC's communications link to peripherals, transferring data to and from main memory under the commands of the CPU). Second, there are peripherals (which consist of different product groupings, including tape and disk drives, printers and terminals).

The copyright laws do not protect this interface information because such information is the key to compatibility with the products within the System/390 family of products. *Computer Associates v. Altai*, 982 F. 2d 693 (2d Cir. 1992)

As we noted in our *Consolidated Reply*, at 10 n.7, until July 5, 1995, IBM committed itself pursuant to the European undertaking to make timely disclosure of the crucial interface information necessary for the design of System/390 compatible products. U.S. Selected Docs. tab 34. IBM's withdrawal from the undertaking casts into doubt its future disclosure intentions, which has heightened our concern over the possible termination of the judgment's disclosure requirements and ban on attempts by IBM to prohibit experimentation with its System/390 mainframe products.

will have to enter an adjacent market (*i.e.*, operating systems), in order to remain in the CEC market. *See Kodak*, 112 S. Ct. at 2091 ("one of the evils proscribed by the antitrust laws [is] . . . the creation of entry barriers to potential competitors by requiring them to enter two markets simultaneously.").³⁹

We also are concerned that if the decree is terminated, IBM may exercise its power against the independents, to the detriment of consumers. Post-decree, IBM may have little incentive to continue to offer purchase options that are no less favorable than lease options, as is currently required by decree section IV (requires IBM to sell at prices that are not substantially more advantageous than lease charges and to make purchase options known to customers) and section VI(a)-(b) (requires IBM to offer to maintain machines that are owned by others and to provide the same services to purchaser that it provides to lease customers). Absent the decree, there are a number of ways IBM could exercise its market power to threaten the viability of the independents. One possibility, is that IBM could promise to maintain only machines that it leases and refuse to maintain the machines that independent vendors provide. Some independent vendors believe this would be fatal to their businesses. A principal reason consumers consider independents (apart from price competition and financing competition) may be because of decree section VI(a)-(c) (which ensures that machines remain eligible for IBM maintenance so long as the used machines are not significantly altered).

Additionally, IBM could exercise its market power to exclude the independents if, post-decree, it returns to a *de facto* lease-only policy. This could jeopardize the competitive

Manufacturers of System/390 compatible systems ("plug compatibles") also may benefit from decree section XV(b), which prevents IBM from tying its various System/390 products together and from decree section VII(d)(3), which prevents IBM from controlling or otherwise subjecting to its approval products that attach to (*i.e.*, that are compatible with) those IBM products. Moreover, plug compatible manufacturers also benefit from decree section VI(b), in that IBM is enjoined from discriminating in its provision of the maintenance and repair of IBM System 390 products at mixed-vendor installations. This guarantee of nondiscriminatory service may be indispensable to competition in the System/390 market in light of the dependence of virtually all System/390 installations on IBM's mainframe operating system software.

viability of the independents to the detriment of consumers because the stock of equipment upon which independents depend may shrink (and this stock is a source of spare parts when machines are cannibalized). Moreover, post-decree these competing entities may not be provided with the disclosure information they currently receive under decree section IX when they purchase a mainframe; this information is integral to the independents when they perform upgrades, which often they do in the course of installing a used machine.⁴⁰

We anticipate that IBM will assert that smaller capacity computers and various types of distributed networking computing environments compete head on with mainframes. This is IBM's prerogative, but to prevail on market definition IBM must show the extent to which (if any) non-mainframe computers share a cross-elasticity of demand with System 390 mainframes (and the same showing would be expected of potential relevant markets subsumed therein, such as CPUs, operating systems and applications). *See Allen-Myland*, 33 F.3d at 200; *Hayden*, 730 F.2d at 70-71. This in turn requires an assessment of whether smaller capacity computers are reasonable substitutes for mainframes, taking into account attributes bearing on the elasticity of demand, including, the computing power, speed and security of mainframes and the ability and willingness of consumers to switch to non-System 390 platforms in response to either hardware or software price increases by IBM. *See supra* _____ n. 16.

In light of the enormous investment that consumers have made in System/390 products, *see supra* note --, we have doubts that consumers would or could switch away from IBM products in response to an exercise of monopoly power by IBM. For many customers, this substantial investment in software means effectively that they are locked-in to the System/390 architecture. Complete conversion of their systems to alternative platforms in many instances would provide for solutions that functionally are not equivalent to mainframe solutions and in any case most often would be prohibitively expensive. It is our understanding that most System/390 consumers literally have millions of lines of code of customized applications programs that have been written for the particular functions and interfaces of the System/390 environment and that conversion of these programs is extremely expensive. Additionally, consumers would have to incur the opportunity costs associated with diverting skilled programmers away from developing new applications to the task of porting existing applications. It appears that few consumers would make this enormous investment of time, money and human resources in response to an exercise of market power by IBM. Even if some customers would make the switch to a different computer system, we have learned of nothing that would prevent IBM from exploiting its market power only as to those users that would not switch.

2. IBM May Possess Market Power in the Aftermarkets for Service and Parts of System 390 Mainframes and AS/400 Mid-range Computer Products.

The *Allen-Myland* case potentially is instructive on some of the government's concerns about outright termination of the decree as it relates to competition in aftermarkets. In *Allen-Myland*, plaintiff Allen-Myland alleged that IBM violated Sherman Act §§ 1 and 2 by creating an upgrade pricing policy effectively which tied IBM mainframe upgrade installation service to the IBM parts needed to perform the service, thereby allegedly injuring competition in the tied product market in which Allen-Myland competed, the market for reconfiguring and upgrading mainframes. *Id.* at 199.⁴¹ In vacating the district court's finding that IBM lacked market power in the market for mainframe computers, the Court of Appeals noted that "[w]hen the [district] court broadened [the] market *that it believed* shared cross-elasticity of demand with large-scale mainframes, IBM's market share dropped from as high as 79% to under 34.4% . . ." *Id.* at 201 (emphasis added and citations omitted).⁴²

As we noted above, the switching costs inherent to migrating mainframe applications to non-mainframe computing platforms should be a focus of this inquiry; certainly the *Allen-Myland* court recognized the importance of switching costs in assessing whether IBM possesses market power: "[i]f it is prohibitively expensive to switch to a smaller capacity computer before the normal end of an application system's life cycle, then IBM, *at least for those locked-in customers, would not face any realistic competition from smaller machines and would thus possess market power as if they did not exist.*" *Id.* at 205 (emphasis added). Because the

⁴¹Allen-Myland defined large-scale mainframes as computers that are "among the largest in memory capacity, the fastest in computing speed, and the most expensive of computers available." *Allen-Myland*, 33 F.3d at 201 (quoting *Allen-Myland v. International Bus. Mach.*, 693 F. Supp. 262, 270-71 (E.D. Pa. 1988)).

⁴²The Court of Appeals observed that "[m]arket power is defined as the ability to 'raise prices or to require purchasers to accept burdensome terms that could not be exacted in a completely competitive market.'" *Allen-Myland*, 33 F.3d at 200 (quoting *United States Steel Corp. v. Fortner Enters., Inc.*, 429 U.S. 610, 620 (1977)).

district court cited only "anecdotes" suggesting that smaller computers compete against vigorously against mainframes, the Court of Appeals admonished against reliance upon an incomplete set of facts:

[o]ur review of the record, however, shows that none of the incidents mentioned involved a mainframe user with a significant base of applications software and data that would have to be rewritten and converted before the application could be moved to a smaller computer. Indeed, in the vast majority of cases, the customer was developing a new application and had an unfettered choice of which type of computer to purchase. In a few others, the system was approaching the end of its useful life and was slated for replacement. This evidence, then, does not support the conclusion that there was not a significant lock-in problem.

Allen-Myland, 33 F.3d at 205-06.

The *Allen-Myland* Court's concern for IBM's exploitation of market power against "locked-in" end users was animated by the Supreme Court's decision in *Eastman Kodak Co. v. Image Tech. Servs., Inc.*, 504 U.S. _____, 112 S. Ct. 2072 (1992) ("*Kodak*"). See *Allen-Myland*, 33 F.2d at 205-06 (*citing Kodak*). In *Kodak*, Eastman Kodak manufactured photocopy equipment that it sold in what may have been a competitive market.⁴³ Plaintiffs, independent service operators who provided service and repair to Kodak equipment, alleged that Kodak unlawfully had tied the sale of service for Kodak equipment to the sale of parts for Kodak copiers, in violation of Sherman Act § 1 and had attempted to monopolize the sale of service for Kodak machines in violation of Sherman Act § 2 by restricting the availability of the necessary repair parts to independent service operators like Image Technical. *Kodak*, 112 S. Ct. at 2078. Kodak argued that it could not possess any market power in the aftermarket for service and repair because it lacked market power in the market for new copiers. *Id.* at 2082. The assumed absence of market power in the primary market (here, copiers), however, was not dispositive as a

⁴³ Before the Supreme Court, respondent Image Technical did not contest Kodak's assertion that its market shares indicated a competitive equipment market. *Kodak*, 112 S. Ct. at 2081 n.10. This question, along with the other issues in the case, is being tried in the Northern District of California.

matter of law. *Id.* at 2084.⁴⁴ Rather, the Supreme Court held that under certain circumstances, the fact that the buyer of such equipment was locked into a single supplier could give rise to a finding of market power:
[i]f the cost of switching is high, consumers who already have purchased the equipment, and are thus "locked-in", will tolerate some level of service-price increase before changing equipment brands. Under this scenario, a seller profitably could maintain supracompetitive prices in the aftermarket if the switching costs were high relative to the increase in service prices, and the number of locked-in customers were high relative to the number of new purchasers.

Kodak, 112 S. Ct. at 2087. Rejecting "[l]egal presumptions that rest on formal distinctions rather than actual market realities", 112 S. Ct. at 2082, *id.*, the Supreme Court noted that "[t]he extent to which one market prevents exploitation of another market depends on the extent to which consumers will change their consumption of one product in response to a price change in another, *i.e.*, the 'cross-elasticity of demand'". *Id.* at 2083.⁴⁵

We share the concern of the *Allen-Myland* court. Accordingly, to assuage our concern about IBM's market power in aftermarkets absent the decree, in this proceeding, IBM must demonstrate whether and the extent to which *current System/390 or AS/400 users* can and would

⁴⁴The Court observed that "there is no immutable physical law -- no 'basic economic reality' -- insisting that competition in the equipment market cannot coexist with market power in the aftermarkets." *Kodak*, 112 S. Ct. at 2084. Moreover, the Court also rejected outright Kodak's argument that as a matter of law a single brand of a product -- such as service and parts for Kodak copiers (which were not interchangeable with other manufacturers' services and parts) -- can never be a relevant market for antitrust purposes. *Kodak*, 112 S. Ct. 2090 (*citing, inter alia, du Pont*, 351 U.S. at 404). Thus to the extent parts for IBM system/390 mainframes are not interchangeable with parts from other mainframe manufacturers, those parts may constitute relevant markets.

⁴⁵*Kodak's* emphasis on the primacy of record facts over economic theory was echoed by the Supreme Court in *Brook Group v. Brown & Williamson Tobacco*, 113 S. Ct. 2578, 2591 (1993) (rejecting predatory pricing scheme in oligopoly setting because facts indicated that alleged predator could not recoup monopoly profits to recover from below-cost pricing) ("theory will not stand in the way of liability" when "the realities of the market and record facts" indicate that liability has occurred) (*citing Kodak*). See also *F.T.C. v. Indiana Federation of Dentists*, 476 U.S. 447, 461 (1986) (restrictive dental practices have to be "viewed in light of the reality" that markets for dental services tend to be relatively localized.); *Balaklaw v. Lovell*, 14 F.3d 793, 799 (2d Cir. 1994) ("[t]he basic principle is that the relevant market definition must encompass the realities of competition.") (internal quotation marks omitted).

switch over to alternative computing environments in response to an exercise of market power. Indeed, the government's preliminary discussions with some mainframe end users suggests that for certain data intensive computing tasks, there are no substitutes for mainframes. Moreover, for certain tasks for which theoretically a substitute may exist, many end users have invested enormous amounts of time and money into developing applications that run on IBM mainframes and operating systems. To switch away from IBM computing environments, then, could require inordinate amounts of human resources, money and time.

Such "switching costs" are one of the market "realities" to which courts increasingly are becoming sensitive. So, when confronted with antitrust issues in the context of complex purchases such as computer systems, courts understand that they must direct their factual inquiries into whether competition in the primary equipment market obviates derivative market power opportunities that may be exploited from an installed base of consumers that is "locked-in" to the purchase, potentially reliant upon the manufacturer for aftermarket support or service. *See, e.g., Virtual Maintenance Inc. v. Prime Computer, Inc.*, 11 F.3d 660, 666 (6th Cir. 1993) (remanding for new trial in light of *Kodak* on question of whether computer system manufacturer exercised market power in aftermarkets for its software updates despite interbrand competition in primary market for package of minicomputers and software). Accordingly, as the Government indicated in its Consolidated Reply at 9-10, assessing the competitive implications of IBM's motion therefore requires an evaluation of whether any of IBM's customer currently are "locked in" to any of IBM's products in a manner that has conferred market power and whether the exercise of that market power is beneficially limited by the decree, which enjoins potentially exclusionary conduct like the refusal to sell spare parts and providing maintenance manuals to independent service companies. (*See, e.g., Decree* §§ VI(c) (directing IBM to sell at reasonable and nondiscriminatory prices repair and replacement parts); VII(c) (enjoining IBM from requiring any lessee or purchaser to have IBM repair their electronic data processing equipment);

IX(b)(requiring IBM to make available to customers and independent service organizations at reasonable and non-discriminatory terms technical materials relating to service and repair that are provided to IBM's own maintenance and repair employees).

Whether the decree constrains IBM's exercise of aftermarket market power is relevant both to the mainframe environment -- a market as noted above where the Government suspects IBM possesses primary and perhaps derivative market power -- and also to smaller mid-range computers such as the AS/400 where IBM may possess aftermarket power in light of the large installed base and software investments of AS/400 users. To meet its burden, and assuage government concerns, one would therefore expect IBM to show that there is, in fact, "unfettered customer choice" (*IBM Prelim.* at 22.), in these markets, a characterization of end-user competitive options that rules out any lock-in effect. IBM also must show that by virtue of decree sections VI(c) and IX(c) it is "impaired in seeking to exchange [parts and technical] materials with other manufacturers" and that the net effect of that impairment is anticompetitive.

So to the extent the decree imposes on IBM a "duty" to deal fairly with competitors in aftermarket goods and services (such as selling spare parts and providing manuals to independent service operators) obvious questions are what impact would decree termination have on competition in the primary and secondary markets and what are IBM's intentions with respect to independent service operators. If IBM plans to discontinue its dealings with independent service operators, then an important question is whether it has a valid business reason for doing so and if it does not or the legitimacy of the proffered business reason can be drawn into question, then this would auger in favor of retaining the decree. *See, e.g., High Tech. Careers v. San Jose Mercury News*, 996 F.2d 987, 990-91 (9th Cir. 1993) (reversing grant of summary judgment for defendant newspaper who refused to continue carrying advertising producer's insert as a genuine issue of material fact existed as to whether defendant's proffered business justification was pretextual; "[w]hether valid business reasons motivated a monopolist's conduct is a question of

fact") (citing *Eastman Kodak supra* at 2091 n.32; *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 472 U.S. 585, 602-05 (1985); *Oahu Gas Serv., Inc. v. Pacific Resources, Inc.*, 838 F.2d 360, 368 (9th Cir.), *cert. denied*, 488 U.S. 870 (1988)). Thus it is conceivable post-decree, IBM could have no incentive to continue to maintain used equipment as available for IBM maintenance, to repair used equipment sold by other vendors or even to sell repair parts and manuals to third parties that it regards as competitors.

To be sure, IBM cites as one of the arguments for terminating the decree that a vibrant used equipment/service industry exists. (*IBM Prelim.* at 17-18).⁴⁶ But in heralding the competitive influence of these entities, whose creation IBM agrees was a purpose of the decree, IBM begs the question: if the decree is the reason that this industry has continued to exist, then we must assess whether retention of the decree in whole or in part furthers the public interest in competition.

C. IBM's Arguments Do Not Address The Central Issue of Whether Termination of the Judgment Would Harm the Public Interest In Competition.

Although IBM counsel conceded at the June 19 hearing that the Court must consider the impact of vacating the judgment,⁴⁷ it nonetheless invites the Court to grant its motion without any regard for whether termination would injure the public interest in competition. IBM presents a plethora of arguments in support of its request that the Court ignore the impact of judgment termination on consumers. Thus, it argues that the market for tabulating machines, which was the subject of the complaint, has not existed for many years. (*IBM Prelim.* at 5) ("That

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⁴⁷ IBM counsel stated:

We said, I thought fairly clearly and specifically, what we think the issues are. And they do not -- they should not be read to say that there is no reason to look at the impact of vacating the provisions of the decree at which our motion is directed. That would be, frankly, quite silly a position to take. And we don't take it.

(Transcript of June 19, 1995 Hearing at 19.).

fact alone should be dispositive of IBM's motion to terminate."). It similarly argues that the viability of the judgment must be evaluated solely on the basis of the conduct and market alleged in the complaint and that, since IBM's market power in the tabulating machine market no longer exists, any purposes of the judgment in "dissipating the possible effects of that alleged power in other areas (*i.e.*, EDPM) have been fulfilled ..." (*Id.* at 8.). It complains that, if it is required to show that termination would not harm the public interest in competition, "then the Government's dismissal of its 1969 suit as 'without merit' would be meaningless." (*Id.* at 10.). It suggests that it should benefit from the government's policy, adopted many years after entry of the judgment, of generally limiting decrees to terms of ten years. (*Id.* at 11-12.).

Finally, IBM submits that its evidence must address only three issues. It plans to demonstrate the purposes of the judgment and prove that they have been fulfilled. It plans to show that the computer industry has changed drastically since the judgment was entered. And it plans to show that the judgment harms competition by increasing IBM's costs and making it a less effective competitor. (*Id.* at 13-14.).

As we demonstrate above, to obtain relief in this case, IBM must only prevail on the first of the three issues it has identified by showing that the purposes of the litigation as incorporated in the judgment have been fully achieved. *United Shoe*, 391 U.S. at 248, 88 S. Ct. at 1499. To make this showing, IBM must prove that conditions have changed sufficiently such that continuation of the judgment in any current market would no longer serve to promote the public interest in competition. However, IBM does not propose to show that the purposes of the judgment have been fulfilled, or for that matter make any other showing, in the context of current market conditions. Consequently, IBM's proffered evidence will not be helpful in showing whether continuation of the judgment would harm the public interest in competition. *Western Elec. Co.*, 900 F. 2d at 309; *American Cyanamid Co.*, 719 F. 2d at 567.