

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' MEMORANDUM ON THE 1969 CASE

Kent Brown (KB-5429)
Sanford M. Adler (SA-7428)
Richard L. Irvine (RI-8783)
Don Allen Resnikoff (DR-2017)
Ian Simmons (IS-7468)
James J. Tierney (JT-7842)

U.S. DEPARTMENT OF JUSTICE
Antitrust Division
555 4th Street, N.W.
Suite 9901
Washington, DC 20001
(202) 307-6200

Attorneys for Plaintiff United States of America

David Turetsky
Deputy Assistant Attorney General
Rebecca P. Dick
Deputy Director of Operations
N. Scott Sacks
Assistant Chief, Computers and Finance Section
October 5, 1995

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I. INTRODUCTION

Pursuant to the Court's request at the August 7, 1995 hearing, the Government respectfully submits this Memorandum addressing the significance to this proceeding of *United States v. IBM*, 69 Civ. 200 (S.D.N.Y. 1969) (the "1969 case"). We also respond to several arguments of International Business Machines Corporation ("IBM") in its more recent filing, including its erroneous reiteration that, in ruling on a contested decree termination motion, the Court need not perform a competitive analysis in properly defined markets to assess the competitive consequences of terminating the 1956 Final Judgment ("Final Judgment" or "Decree"). Accordingly, below we show that: (1) the 1969 litigation sought drastic relief against IBM going well beyond the Decree and based on conduct going beyond that proscribed by the Decree; (2) the 1969 litigation does not vitiate IBM's burden of establishing, by means of a forward-looking market analysis required by *United States v. Eastman Kodak Co.*, 63 F.3d 95 (2d Cir. 1995) ("*Kodak*"), that the Decree's purposes have been fully achieved, or that changed circumstances have rendered the Decree incapable of accomplishing its purposes; (3) the Decree contains provisions designed to constrain the exercise of market power by IBM in computers (*i.e.*, electronic data processing machines ("EDPM")); and (4) operating system software is covered by the Decree.

II. THE 1969 CASE SOUGHT STRUCTURAL RELIEF BASED ON IBM'S ALLEGED PREDATORY ACTIONS THAT WENT BEYOND THE CONDUCT COVERED BY THE 1956 DECREE

We do not seek to relitigate the 1969 case. In fact, the 1969 case simply did not address the issues now before the Court. It did not address, much less resolve, whether IBM currently has market power in any market covered by the Decree such that continued Decree enforcement constrains the exercise of that power. In short, we submit that the 1969 case has no bearing on whether the purposes of the Decree have been fully achieved or whether changed circumstances have rendered the Decree incapable of accomplishing its purposes. The 1969 litigation, then, is irrelevant to the question whether the Decree should be terminated.

A. The 1969 Case Alleged That IBM Illegally Acquired And Maintained Its Monopoly Of General Purpose Digital Computers Through Exclusionary And Predatory Conduct Going Beyond The 1956 Decree.

The 1969 action alleged that IBM had undertaken exclusionary and predatory conduct with the aim and effect of eliminating competition so that IBM could maintain its monopoly position in general purpose digital computers. (*See Plaintiff's Statement of Triable Issues* (dated September 23, 1974) at 8; *U.S. 1969* tab 1.) Specifically, the Government contended that from 1961 to 1969 IBM engaged in anticompetitive practices "for the purpose or with the effect of restraining or attempting to restrain actual or potential competitors from entering" the relevant markets. (*Id.* at 8.)¹ Such practices allegedly included anticompetitive price discrimination such as giving away software services for "the purpose or with the effect of . . . enabling IBM to maintain or increase its market share" (*Id.* at 9.) The Government also alleged that IBM's bundling of software with "related computer hardware equipment" for a single price was anticompetitive. (*Id.* at 10.)

¹ IBM erroneously asserts that the Government conceded that IBM did not have monopoly power prior to 1961. (*IBM 1969 Mem.* at 18 & n.12.) In its Complaint the Government alleged that "beginning in or about

The Government further averred that IBM predatorily priced and preannounced specific hardware that the Government termed "fighting machines." (*Id.* at 12-14.) IBM allegedly introduced certain products "knowing [the products] had unusually low profit expectations." (*Id.* ¶ 1 at 12 .) Allegedly, IBM "developed and announced" the specified hardware products "primarily for the purpose or with the effect of discouraging actual and potential customers from acquiring . . . [competing products] . . . in markets . . . where IBM's monopoly position had eroded or threatened to erode." (*Id.* ¶ 3 at 12.) Also, in an effort to deter entry and injure competition, IBM allegedly "announced future production and marketing [of certain products] when it believed or had reason to believe that it was unlikely to be able to produce and market such products within the announced time frame" (*Id.* ¶ 5 at 13.) Additionally, the Government alleged that IBM was engaged in various below cost and discriminatory discount conduct in marketing its products to educational and scientific institutions (*Id.* at 14-16) in order to injure peripheral manufacturers and leasing companies. (*Id.* at 16-19.)

To remedy these alleged violations, the Government sought, *inter alia*, divestiture.

(*See Amended Complaint* ¶ 7 at 11; *U.S. Selected Docs.* tab 25; *Plaintiff's Preliminary Memorandum on Relief* (dated October 13, 1972) at 3-4; *U.S. 1969* tab 1.) Rather than merely

1961 and continuing up to and including the date of the filing of this amended complaint", IBM "has attempted to monopolize and has monopolized" the general purpose digital computer systems market through the conduct specified in paragraph 20 of the Complaint. (*see Amended Complaint* (dated January 17, 1969) ¶ 19 at 6 ; *U.S. Selected Docs.* tab 25) ("Pursuant to and in furtherance of the aforesaid attempt to monopolize and the monopolization, the defendant has pursued a manufacturing and marketing policy that has prevented competing manufacturers of general purpose digital computer systems from having an adequate opportunity effectively to compete for business in the general purpose digital computer systems market and has done, among other acts, the following") (*Amended Complaint* ¶ 20 at 7) (emphasis added).) *See also Plaintiff's Statement of Triable Issues* at 8 ("[w]hether an intent to monopolize is evidenced in part by IBM's marketing practices relating to pricing; leasing; maintenance; product announcements and product developments; customer or supplier relations or educational allowances."). IBM thus confuses the issue of whether a firm has market power (which it may have without violating the Sherman Act) with the question of whether a firm is engaging in conduct that violates § 2 of the Sherman Act, 15 U.S.C. § 2. The Complaint, however, recognizes that distinction and its reference to 1961 does not amount to a concession that IBM lacked market power in the preceding decade.

seeking to constrain the exercise of market power by proscribing or requiring certain conduct as the Decree does, the 1969 action requested the far more drastic remedy of divestiture.

Moreover, IBM misreads history when it asserts that the Government in 1982 concluded that IBM lacked market power in EDPM. The Government dismissed the 1969 action on the basis of its failure to prove that "[IBM] maintained [its] market share by some unpermitted practices" (*Transcript of Assistant Attorney General Baxter's Department of Justice Press Conference* (Jan. 8, 1982) at 7; *U.S. Selected Docs.* tab 31.) Assistant Attorney General Baxter stated that "the record is very, very weak on the existence of any such unpermitted or unlawful practices." (*Id.*) He also stated, however, that IBM had "a very substantial market share, depending on how one defines the market precisely . . ." and that "indeed today IBM continues to have a very substantial market share." (*Id.* at 6.) Notably,

Assistant Attorney Baxter pointed out:

It would not be impossible to say that IBM has a monopoly position within the meaning of Section 2 doctrine, although that is a debatable question. But it is not a violation of Section 2 to have a monopoly position. One must have either attained it unlawfully or maintained it by unlawful acts. It is perfectly clear from the record that IB[M] obtained its very large market share in an entirely legal way.

(*Id.* at 6-7.)

IBM seeks to use the Government's voluntary dismissal of the 1969 case as a basis for precluding the Government and this Court from addressing the issue of market power in this proceeding. Although IBM as the moving party bears the burden of proving that termination of the judgment serves the public interest in competition, IBM claims it would be "unfair" to permit a market power analysis. (*IBM 1969 Mem.* at 21). Any unfairness, however, will befall the public interest if the Government and this Court are denied the opportunity to assess the competitive consequences of termination should IBM be permitted to circumvent its burden of proof. Ironically, by relying on the voluntary dismissal of the 1969 action in asking the Court to preclude the Government from undertaking a meaningful assessment of the instant motion, IBM

effectively seeks all of the benefits of *res judicata* and issue preclusion without satisfying any of their prerequisites.^{2/} Indeed, it is doubly ironic that in seeking to preclude the Government from undertaking a meaningful competitive analysis of the termination motion (something no court has ever examined), IBM essentially asks the Court to impute greater preclusive effect to the 1969 voluntary dismissal than would have arisen *had IBM actually prevailed on the merits at trial* that its 1961-1975 conduct was not illegal.^{3/}

The dismissal of the 1969 action therefore is irrelevant to the issues now before the Court, including those relating to IBM's present and future market power. In fact, as we have pointed out (*U.S. Prelim.* at 48-50), had Assistant Attorney General Baxter felt that the 1969 dismissal was dispositive on all market power questions, presumably he would have agreed with IBM's request to terminate the 1956 Decree. In fact, he declined the request solely on the basis of the 1969 record and authorized a decree termination investigation that was closed with no action after IBM failed to produce requested information.

² *In re PCH Assocs.*, 949 F.2d 585, 593 (2d Cir. 1991) (*res judicata* and collateral estoppel may be given preclusive effect only where judgment in prior suit entered on the merits.)

³ Because Decree issues were not litigated during the 1969 trial, such "nonfindings" would be fatal to an assertion that they were "necessary" to any 1969 final judgment on the merits. *Jim Beam Brands Co. v. Beamish & Crawford Ltd.*, 937 F.2d 729, 734 (2d Cir. 1991) ("*if an issue was not actually decided in a prior proceeding, or if its decision was not necessary to the judgment, its litigation in a subsequent proceeding is not barred by collateral estoppel.*") (citations omitted). *Indeed, where time has passed and circumstances have changed, courts generally deny res judicata effect to subsequent suits against the same defendant under the theory that the defendant's conduct since the prior dismissal gave rise to a new cause of action. See, e.g., Lawlor v. National Screen Serv. Corp.*, 349 U.S. 322, 327-28 (1955) (dismissal of previous antitrust suit with prejudice did not bar plaintiff from bringing later suit challenging similar antitrust violations); *FTC v. Raladam Co.*, 316 U.S. 149, 152-53 (1942) (vacation of FTC cease and desist order on grounds of inadequate findings did not bar later proceeding based on same conduct); *Cellar Door Prods., Inc. v. Kay*, 897 F.2d 1375, 1378 (6th Cir. 1990) (dismissal of earlier antitrust action with prejudice did not bar subsequent suit challenging same conduct.)

B. The 1969 Predatory Interface Manipulation Issues Are Different From The Interface Issues Under The Decree.

IBM's interface disclosure practice is the only specific conduct that IBM states was fully litigated during the 1969 case. (*See IBM 1969 Mem.* at 29-33.) However, the interface issues now before the Court differ from the interface issues in the 1969 action. In the 1969 action, the Government alleged that IBM manipulated specific interfaces with the intent and effect of injuring competition. (*See Plaintiff's Statement of Triable Issues* at 16-18; *U.S. 1969* tab 1.) In contrast, here we must assess the consequences of terminating IBM's obligation to disclose *any* interface information at *any* time, apart from IBM's right to manipulate peripheral interface information *prior* to releasing it or to refrain from releasing that information *prior* to product shipment.^{4/}

Specifically, the 1969 action alleged that IBM predatorily manipulated interfaces for the purpose of excluding competition. IBM allegedly changed interfaces for some new products with the purpose of rendering competing products incompatible or obsolete, thereby insulating IBM's products from competition until plug compatible manufacturers had converted their products to the new interface. This attempt to exclude competition allegedly raised plug compatible manufacturers' costs because it required them to make continuous investments to adapt their products to new interfaces. Moreover, because IBM allegedly did not always provide all interface specifications at the time of new product announcements (*IBM 1969 Mem.* at 31) (which generally precede actual product shipment), plug compatible manufacturers' ability to design products implementing the new interface sometimes was allegedly delayed until IBM disclosed the specifications *at the time of product shipment*. (1969 U.S. Pretrial Br. at 148; *U.S.*

⁴ Although the Decree requires the disclosure of interface information, it does not prohibit IBM from *changing* product interfaces or designing new products that result in *different* interfaces. Nor does the Decree forbid IBM from changing interfaces for the purpose of eliminating competition from compatible product manufacturers -- the 1969 theories. Likewise, the Decree imposes no requirement that IBM disclose interface information *prior* to actual delivery of a computer to the purchaser or lessee.

Selected Docs. tab 32.) This allegedly placed compatible manufacturers at a severe disadvantage because the competitive products that they ultimately developed had a much shorter life than the comparable IBM products. (*Id.* at 148, 170; *Government's Opening Statement, May 19 1975 Tr.* at 133-34; *IBM 1969 Author.* tab 8.)

The 1956 Decree does not require disclosure of interface information before product shipment. Section IX(c) of the Decree requires IBM to provide to IBM computer purchasers and lessees, on a nondiscriminatory basis and at a reasonable charge, manuals, books of instruction, diagrams and other similar documents pertaining to the operation or application of their computers. (*See U.S. Prelim.* at 5.) Moreover, Section IX(b) requires IBM to provide to IBM computer owners, at reasonable and nondiscriminatory charges, technical manuals, books of instruction, diagrams and other similar documents that it provides generally to its own repair and maintenance employees. (*Id.*) IBM has complied with these provisions in part by disclosing interface information to IBM computer purchasers, including manufacturers of compatible equipment. As IBM acknowledged in its 1969 case *Pretrial Brief*: IBM also publishes manuals which make available to other manufacturers the detailed interface specifications necessary for manufacturers to manufacture equipment which will communicate with IBM processing units and replace IBM equipment.

(*IBM 1969 Pretrial Br.* at 111; *U.S. Selected Docs.* tab 33.)

And as counsel for IBM argued during the 1969 case:

I do not know of any claim made in any statement of the issues, in any brief, in any opening statement, that asserts a claim of any kind by the plaintiff against the defendant in this case relating to what information IBM ought or should or does make available with respect to its products to other persons.

(*1969 case Tr.* at 36957; *IBM 1969 Author.* tab 9.) In contrast, IBM's counsel was very familiar with the information disclosure provisions of the Decree and sought assurance that the

Government was not contending that IBM was in violation of the Decree:

On the other hand ... there is a provision in the consent decree that your Honor signed, which requires IBM to make certain kinds of information available at

certain times and under certain conditions. And I do not perceive there to be claim being made, or if there is I would like to know that, that there is some violation of that decree.

(*Id.* at 36957.) Government counsel confirmed that the Government was not alleging that IBM withheld information from plug-compatible manufacturers in violation of the Decree. (*Id.* at 36959.)

Even after dismissal of the 1969 case, the European Commission continued proceedings alleging, among other things, that IBM abused its dominant position in the European Community by failing to make advance disclosure of interface information *before* product shipment to permit the timely development of competitive compatible products. (*Aug. 2, 1984 Press Release from the Commission of the European Communities, No. IP (84) 290.* at 11444, 11446-447; *U.S. Selected Docs.* tab 34.) IBM resolved that case with an Undertaking that specified conditions under which IBM would disclose interface information prior to the date of product shipment. IBM has now withdrawn from the Undertaking and, to date, we have been unable to learn how IBM plans to change its interface disclosure policies. The withdrawal ended any formal obligation of IBM to make advance disclosures of interface information, and this development may adversely affect the competitive viability of plug-compatible equipment manufacturers. The Decree therefore imposes the sole surviving requirement that IBM disclose any interface information, but it does not require disclosure prior to product shipment. Accordingly, the information disclosure provisions in the Judgment should not be terminated unless a careful analysis establishes that they no longer serve to constrain IBM's exercise of market power by requiring disclosure of interfaces and other information.

III.THE 1969 CASE SHEDS NO LIGHT ON *KODAK'S* CONTROLLING INQUIRY

A. The 1969 Case Provides No Dispositive Information On The Likely Effect Of Decree Termination Under Current Market Conditions.

IBM asserts that the Government's dismissal of the 1969 case should relieve IBM of its burden of proving, through an assessment of current market conditions using standard antitrust analysis, that Decree termination is consistent with the public interest in competition because the Decree has accomplished its purpose or because changed circumstances have rendered the Decree incapable of accomplishing its purposes. More precisely, IBM contends that it should not be required to perform a competitive analysis of the likely effect of Decree termination because the Government ultimately dismissed the 1969 case and that case also concerned the computer industry. (*IBM 1969 Mem.* at 21-29.)

IBM's suggestion that the evidence adduced in the 1969 case disposes of the need for any market analysis in this Decree proceeding runs afoul of the requirement in *Kodak* and other controlling authority that IBM's termination motion be assessed under present market conditions. (*U.S. Prelim.* at 23-24, 29 n.30.) As shown below, *Kodak* establishes that if the Government opposes antitrust decree termination, the defendant has the burden of proving that under current market conditions, it is in the public interest to lift the decree. As demonstrated by the Second Circuit's extensive market power inquiry in *Kodak*, market definition is a prerequisite to this assessment. (*Id.* at 26-34.)

Furthermore, market characteristics such as lock-in and switching costs bear on demand substitutability and are factual predicates that any meaningful antitrust analysis must address. (See *U.S. Prelim.* at 29-33; 40-44.) A large mainframe shop with hundreds of legacy applications cannot switch to another platform as easily as someone might switch from a pen to a pencil. The magnitude of those switching costs, as well as other factors important in defining relevant markets, are issues of fact for which the 1969 case provides no useful data. The information pertaining to market definition in the 1969 case is dated and of no value in defining markets today.^{5/} Moreover, Supreme Court cases subsequent to the dismissal of the 1969 case have clarified the proper role of market definition and competitive analysis in monopolization cases. See, e.g., *Eastman Kodak Co. v. Image Technical Servs., Inc.*, 504 U.S. 451, 465-78 (1992); *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 472 U.S. 585, 600-05 (1985); see also II P. AREEDA & H. HOVENKAMP, ANTITRUST LAW ¶ 334c at 120 (1995); *U.S. 1969* tab 2 ("courts may refuse to follow an earlier validation of the defendant's conduct if significant intervening change has occurred in the decisional law"); (*U.S. Prelim.* at 29-31; 40-45.)

⁵ After incorrectly asserting that the Government made a binding concession about IBM's market share in 1982, IBM chastises the Government for its reliance on market share data reported in *Allen-Myland, Inc. v. International Business Machs. Corp.*, 33 F.3d 194 (3d Cir.), *cert. denied*, 115 S.Ct. 684 (1994), because "the AMI trial took place in 1987, and involved events occurring during the period 1980 to 1985 — hardly the basis for any reasonable inference about IBM's supposed 'market' share of 'mainframes' today." (*IBM Reply Br.* at 22 n.10.) *A fortiori*, evidence from a trial that ended in 1982 and involved events occurring in the 1960s and the early 1970s is of little value in defining markets today. In addition, IBM's implicit suggestion that the dismissal of the 1969 action proves that IBM is not a monopolist in a relevant market (e.g., *IBM 1969 Mem.* at 21-23) is refuted by the *Allen-Myland* litigation. If the 1969 litigation permanently resolved all market power questions in IBM's favor with the certainty IBM would have this Court summarily accept, then it is difficult to explain why IBM lost on appeal in *Allen-Myland*.

B. Kodak Requires That The Court Employ Standard Antitrust Analysis To Assess The Likely Effect Of Decree Termination Under Current Market Conditions.

We concur with IBM that *Kodak* articulates the standard the Court must employ in ruling on a contested motion to terminate an antitrust consent decree. (*IBM 1969 Mem.* at 4.) However, after acknowledging that *Kodak* is controlling authority, IBM retreats from the decision's import. *Kodak* requires a showing that the Decree's purposes have been fully achieved or that changed circumstances have rendered the Decree incapable of accomplishing its purposes. That requirement necessitates an assessment of current market conditions using standard antitrust analysis. *Kodak* and other important authority, such as *United States v. American Cyanamid Co.*, 719 F.2d 558 (2d Cir. 1983), *cert. denied sub nom. American Cyanamid Co. v. Melamine Chem. Inc.*, 465 U.S. 1101 (1984), and *United States v. Western Elec. Co.*, 900 F.2d 283 (D.C. Cir.), *cert. denied sub nom. MCI Communications Corp. v. United States*, 498 U.S. 911 (1990), thus flatly contradict IBM's assertion that the Decree may be terminated without resort to standard market analysis.

In fact, the Second Circuit in *Kodak* specifically endorsed the market-based methodology of the District Court:

[T]he district court required Kodak to prove that: (1) it no longer possesses market power over film and photofinishing, and therefore that the primary purposes of the decrees — the elimination of monopoly and unduly restrictive practices — have been achieved; and (2) termination of the consent decrees would benefit consumers.

Kodak, 63 F.3d at 102. The Court of Appeals reached this decision on the basis of its analysis of *Rufo v. Inmates of Suffolk County Jail*, 502 U.S. 367 (1992), and *United States v. United Shoe Mach. Corp.*, 391 U.S. 244 (1968).

The Court of Appeals noted that *Rufo* requires the party seeking decree termination or modification to establish that a "significant change in circumstances warrants revision of the decree." *Kodak*, 63 F.3d at 101 (quoting *Rufo*, 502 U.S. at 383).^{6/} The Court of Appeals observed that nothing in Fed. R. Civ. P. 60(b)(5) exempts antitrust consent judgments from the equitable considerations that *Rufo* recognized must guide the power of courts to modify

⁶ The Second Circuit quoted further from *Rufo* in describing what could constitute a showing of changed circumstances:

[W]here changed factual conditions make compliance with the decree "substantially more onerous"; where the decree proves unworkable because of unforeseen obstacles; or where enforcement of the decree would be detrimental to the public interest.

Kodak, 63 F.3d at 101 n.3 (quoting *Rufo*, 502 U.S. at 383-84); *see also U.S. Prelim.* at 19.

or terminate consent decrees. *Kodak*, 63 F.3d at 101. The Second Circuit also confirmed that *United Shoe* provides the initial standard that must be considered in antitrust consent decree proceedings:

However, we also believe that *United Shoe* provides a useful starting point for evaluating an antitrust defendant's request to modify or terminate a consent decree. In most cases, the antitrust defendant should be prepared to demonstrate that the basic purposes of the consent decrees — the elimination of monopoly and unduly restrictive practices — have been achieved. *See United Shoe*, 391 U.S. at 248.

Kodak, 63 F.3d at 101. While there may be some other limited circumstances that would warrant termination or modification of an antitrust consent decree, such as a change in controlling law or when changed circumstances render the decree ineffective in achieving its goals, *Kodak* confirms that:

[A]s a general matter, . . . an antitrust defendant should not be relieved of the restrictions that it voluntarily accepted until the purpose of the decree has been substantially effectuated, or when time and experience demonstrate that the decree "is not properly adapted to accomplishing its purposes."

Id. at 102 (citation omitted).

The only accurate way to determine if the purpose of an antitrust consent decree has been fully achieved or if changed circumstances have rendered the decree incapable of accomplishing its purposes is to conduct a market analysis. (*U.S. Prelim.* at 23-29.) The Second Circuit in *Kodak* meticulously undertook that analysis:

In determining whether a firm possesses market power, "the first step in a court's analysis must be a definition of the relevant markets." *Berkey Photo, Inc. v. Eastman Kodak Co.*, 603 F.2d 263, 268 (2d Cir. 1979), *cert denied*, 444 U.S. 1093 . . . (1980). Without a definition of the relevant market, there is no way to measure a company's ability to act as a monopolist. *Walker Process Equip., Inc. v. Food Mach. & Chem. Corp.*, 382 U.S. 172, 177 . . . (1965).

Kodak, 63 F.3d at 104.

The Court of Appeals then conducted an extensive review of the District Court's market analysis and concluded that the District Court had applied the correct legal principles and that its factual findings were supported by the record. *Id.* at 109. In considering the Government's objections to the District Court's factual conclusions, *id.* at 104-09, the Second Circuit employed the same "standard framework" for defining relevant markets and assessing market power that it had earlier required of the District Court in *American Cyanamid*, 719 F.2d at 566-67, and that we urge on the Court in this case. (*See U.S. Prelim.* at 23-24, 29 n.30.)^{7/} Here, too, the Court must apply established antitrust law to assess whether the Decree has achieved its purpose or whether changed circumstances have rendered the decree incapable of accomplishing its purposes.^{8/}

⁷ IBM suggests that *American Cyanamid* is inapplicable to this proceeding because the judgment in that case permitted the defendant to seek termination under a standard drawn from Section 7 of the Clayton Act, 15 U.S.C. § 18. (*IBM 1969 Mem.* at 7.) The Second Circuit in *American Cyanamid*, however, concluded, 719 F.2d at 565-66, that the standard for decree termination under the language in the decree was identical to the standard that applies to this case (*i.e.*, whether termination of the decree would serve the public interest in competition). (*See U.S. Prelim.* at 17-21, 23-24 & n.22.) In *American Cyanamid* the Government consented to the defendant's motion and the District Court initially applied the deferential standard of review that is generally appropriate when the Government consents to termination. *American Cyanamid*, 719 F.2d at 567; *see also (U.S. Prelim.* at 21-23.) Because the decree specifically provided a standard for termination, the Second Circuit precluded the deferential review in that case and instead required the District Court to review the motion within the "standard framework" for antitrust analysis. *Id.* at 566-67. The effect of the judgment termination provision in *American Cyanamid* therefore was to impose, despite the Government's consent, the traditional standard that applies when the Government does not consent.

⁸ IBM attempts to undermine the continuing validity of *American Cyanamid* by pointing out that it was not cited in *Kodak*. (*IBM 1969 Mem.* at 8.) However, the major propositions for which we have cited *American Cyanamid* in our *Preliminary Statement*, decree interpretation and the need to conduct a competitive analysis of the likely effect of judgment termination (*see U.S. Prelim.* at 10-11, 14, 23-24, 29 n.30), were not major issues on appeal in *Kodak*. Both *Kodak* courts agreed that the decrees applied to film and photofinishing and the District Court's application of the standard antitrust analysis was endorsed by the Second Circuit. *Kodak*, 63 F.3d at 109.

C. The Termination Test That IBM Proposes Does Not Conform To The Requirements Of Kodak.

IBM claims that under *Kodak* it will be entitled to Decree termination upon a showing that its market power in tabulating machines has dissipated and that it has not engaged in the restrictive practices enjoined by the Decree. (*IBM 1969 Mem.* at 10.) IBM plans to satisfy the test's first prong by showing that it no longer manufactures tabulating machines and that the tabulating industry no longer exists. IBM apparently would seek to satisfy the second prong merely by showing that it has complied with the Decree's restrictions in the computer industry.^{9/}

Conspicuously absent from IBM's proposal is any requirement that it demonstrate that the purposes of the Decree with respect to computers have been fully achieved through an assessment of the likely effect of judgment termination on the public interest in competition in the computer industry. IBM thus seeks termination without regard to whether the judgment plays a continuing role in preserving competition. (*See IBM Prelim.* at 16-19; *IBM 1969 Mem.* at 10.) It argues, inconsistent with *Kodak*, that the Court should consider irrelevant whether termination would result in higher prices or reduced output or innovation in any market other than the market for tabulating machines.^{10/}

IBM recognizes that the *Kodak* court inquired into whether the defendant

⁹ Instead of stating precisely how it plans to satisfy the second prong, IBM cites to the pages in its *Preliminary Statement* in which it indicates its intention also to show that IBM now sells computers and that second-hand computer dealers and independent service organizations ("ISOs") exist (*IBM Prelim.* at 16-19), apparently to demonstrate compliance with the Decree's provisions.

¹⁰ IBM also claims that it fits within the narrow exception to *Kodak's* usual requirement that a defendant seeking a contested judgment termination must show that the decree's purpose has been achieved. IBM apparently plans to show that circumstances have changed sufficiently that the Decree has become inequitable. (*IBM 1969 Mem.* at 3-4, 8-9 & n.5.) However, IBM apparently plans to satisfy this narrow exception solely by offering evidence that circumstances have "changed" as described in its *Preliminary Statement* (*IBM Prelim.* at 19-28), without regard to the competitive implications of those "changed circumstances," or whether the "changed circumstances" have rendered the Decree incapable of accomplishing its purposes.

continued to possess market power. (*IBM 1969 Mem.* at 4-5.) However, IBM claims that a market power analysis was required in *Kodak* solely because the decrees in that case were intended to remedy Kodak's monopolies in the film and film processing markets and because Kodak continued to compete in those markets. In contrast, IBM asserts, the Decree's purpose was not to remedy any monopoly in the computer industry. Therefore, it argues, despite the Decree's clear applicability to the computer industry, it can satisfy the *Kodak* standard without an examination of IBM's power in any market for computer products or services. (*Id.* at 6.) But this overlooks the fact that one clear purpose of the Decree was to prescribe relief in the EDPM industry to prevent a recurrence of the harms imposed by IBM's practices in the tabulating machine industry. And before terminating the Decree, this Court must assess whether that purpose has been accomplished.

Kodak recognizes that a court must be "guided by equitable considerations." *Kodak*, 63 F.3d at 101. In applying these considerations, the court specifically approved as "a proper basis for the court's decision to terminate the consent decrees," a requirement that the defendant prove that it no longer possesses market power and that termination would benefit consumers. *Id.* at 102.¹¹

It would be inequitable under *Kodak* to terminate a decree that benefitted consumers by constraining the exercise of IBM's market power, when termination would deprive

¹¹ This language contradicts IBM's argument that it need not show the likely competitive effects of judgment termination and that no such review of the effects of termination was undertaken in *Kodak* with respect to the 1954 photofinishing decree. (Aug. 7, 1995 Tr. at 34-35.) Indeed, the Court of Appeals noted that the District Court found that "allowing Kodak to sell film and photofinishing as a bundle [the conduct enjoined by the 1954 decree] would enhance competition." *Kodak*, 63 F.3d at 98, 100. This statement was based on the District Court's findings that Kodak did not have market power in the photofinishing or film markets. *Id.* at 98, 99-100, 109. The latter findings eliminated the possibility that bundling the two products would lead to an anticompetitive result. *United States v. Eastman Kodak Co.*, 853 F. Supp. 1454, 1486-87 (W.D.N.Y. 1994), *aff'd*, 63 F.3d 95 (2d Cir. 1995). Thus, contrary to IBM's argument (Aug. 7, 1995 Tr. at 34-35), the *Kodak* court's methodology in assessing the proposed termination of the 1954 photofinishing decree corresponds to the methodology we urge on the Court in this proceeding.

consumers of the protection from anticompetitive conduct afforded by the provisions to which IBM consented. This is true regardless of whether the applicable decree provisions protect against conduct that resulted in the charged violation or other anticompetitive conduct. In *Kodak*, the 1921 decree imposed both short and long term obligations. Over the short term, the decree required the dissolution of the combination that was found to violate the antitrust laws. Over the long term, the decree enjoined certain anticompetitive sales and distribution practices. Although the *Kodak* court found that Kodak had satisfied its short-term decree obligations long ago, thus eliminating any lasting effects from the original antitrust violations, *Kodak*, 63 F.3d at 98, the court nonetheless engaged in a detailed market analysis to determine whether Kodak had market power. *See also id.* at 108 (indicating that whether a defendant's market power derives from its illegal monopoly or from its continued leadership in the industry has no relevance).

IBM also seeks to avoid *Kodak's* market analysis requirement on the grounds that in *Kodak*, unlike this case, there was no difference between the markets covered by the decrees and the markets that were the subjects of the antitrust violations alleged in the complaint. (*IBM 1969 Mem.* at 5; Aug. 7, 1995 Tr. at 20-21.) But the 1921 *Kodak* decree did not result from an allegation of monopolization in the film market alone. It resulted from a finding that Kodak had monopolized the combined market for photographic supplies which included cameras, film, plates and photographic paper. *Kodak*, 63 F.3d at 98; *see also United States v. Eastman Kodak Co.*, 226 F. 62, 64, 79-80 (W.D.N.Y. 1915). *The decrees constrained Kodak's conduct with respect to all articles and supplies and did not apply solely to film.*

During the *Kodak* termination proceeding, the Government agreed to terminate the decree in its application to all products except film. Nonetheless, just as IBM has suggested that any market analysis in the computer industry in this case should be limited to all EDPM because the decree does not distinguish between different types of computers (*IBM 1969 Mem.* at 24-25 n.16; *IBM Reply Br.* at 13), Kodak argued that the court should examine market power

only in the market found to have been the subject of monopolization, photographic supplies, and not in the market of concern to the Government, film.^{12/} The District Court not only rejected this argument but also analyzed whether all speeds and sizes of color film and types of photofinishing, respectively, were in the same markets. *See Kodak*, 853 F. Supp. at 1467 (relevant market includes amateur color negative film of all speeds and sizes); 1483-85 (relevant market includes all types of photofinishing). The court's aim was to determine markets that reflected current economic conditions, just as must be done in this case. (*U.S. Prelim.* at 23-24, 29 n.30, 41-42 & nn.44-45.) Plainly, these inquiries, as well as the court's extensive analysis of geographic market issues, would have been unnecessary if the contours of the relevant market in a judgment termination proceeding were dictated not by market realities but by the complaint's allegations or the decree's terminology.

IBM's contention that it need not satisfy *Kodak's* market analysis requirement because the computer industry was not mentioned in the Complaint, contradicts the only authority that has specifically addressed that issue. To our knowledge, *Western Elec.* is the only antitrust case that expressly addresses the standard of review of a motion to terminate a decree restriction that was not a subject of the original litigation. *Western Elec.*, 900 F.2d at 307-09.

¹² Kodak's counsel argued:

The market which was alleged to have been monopolized in 1913 and again in the 1915 opinion was the market for photographic supplies defined as film, cameras, papers and chemicals.

The undisputed testimony before this Court is that Kodak has a very small worldwide or United States market in photographic supplies defined in that way.

That testimony is uncontroverted.

With all the discussion which has been offered about the film market and the photofinishing market, if you return to the complaint and to the 1915 decision and if you define as that Court did then photographic supplies, and if you look at the remedy which was fashioned with respect to photographic supplies, Kodak's market share worldwide or in the United States is below twenty percent.

Now, the government can't have it both ways. It can't say that Kodak must prove that it has no market power as it did in 1915 and then change the definition of the market.

Kodak, March 24, 1994 Tr. at 1569; *U.S. 1969* tab 3.

That case involved the AT&T consent decree's restriction on the provision of information services by the Regional Bell Operating Companies ("BOCs"). In determining the appropriate standard of review of a motion to terminate the restriction, the court first noted that the AT&T antitrust litigation centered exclusively on the interexchange-service and equipment-manufacturing markets and not on information services. *Id.* at 307. In fact, "there was no record to speak of concerning AT&T's activities in the information services market. The parties agreed to the information services restriction as a precautionary measure in light of uncertainty about how divestiture of AT&T would affect the development of this embryonic market." *Id.* Under these circumstances, it would not have been erroneous for the District Court initially to approve a decree without the information services restriction. *Id.* Nonetheless, the information-services restriction could not be terminated if "removing it would be against the public interest *now*." *Id.* at 308 (emphasis added).

Because the Government consented to termination of the information-services restriction in *Western Elec.*, the Court of Appeals also held that the District Court should employ the deferential standard of review that is applicable to uncontested motions. *Id.* at 308-09; *see also* (*U.S. Prelim.* at 21-23.) Yet, even under this more lenient standard, the Court of Appeals required that the review focus on whether termination "would be anticompetitive under current market conditions." *Id.* at 309. *Western Elec.* thus firmly establishes that it is irrelevant in the current proceedings that the computer industry was not the focus of the 1952 Complaint. Although the computer-related relief in the Decree applies to an industry that was not mentioned in the Complaint, just like the information services restrictions in the AT&T Decree, the Court still must focus its inquiry in this proceeding on whether termination of the Decree "would be anticompetitive under current market conditions." *Id.* at 309.^{13/}

¹³ The cases IBM cites do not support its position but rather are consistent with *Western Elec.* *See United States v. National Broadcasting Co.*, 842 F. Supp. 402 (C.D. Cal. 1993); *United States v. Swift & Co.*, 1975-1 Trade Cas. (CCH) ¶ 60,201 (N.D. Ill. 1975). Those cases provide no discussion of the appropriate standard in a termination proceeding involving decree provisions that were not the subject of the original

IV. THE 1969 CASE SHEDS NO LIGHT ON WHETHER THE DECREE'S PURPOSE HAS BEEN FULFILLED AND IBM'S PROFFERED "PURPOSE" IS CONTRARY TO THE DECREE'S TEXT, PROPER DECREE INTERPRETATION AND THE FACTS

Since the 1969 case challenged conduct going beyond the 1956 Decree, and sought additional relief, it sheds no light on whether the purpose of the Decree has been fulfilled.

Failing to acknowledge the significant differences between the 1969 action and the Decree, IBM mistakenly asserts that, if the Decree was meant to impose comprehensive regulation of IBM in the EDpM market, then the 1956 settlement presumably would have been *res judicata* to the 1969 action. (*IBM Prelim.* at 10.) But this argument not only ignores the law of *res judicata* (*see supra* at 5 & nn.2-3), it wrongly presumes that if the Government obtained relief in the EDPM market in 1956, it could not obtain additional relief in 1969. Yet the Government could have sought additional relief if, as was alleged in the 1969 case, IBM had been engaging in *different* anticompetitive conduct than that proscribed by the Decree.

litigation. Both cases involved proceedings in which the Government consented to termination, as did the sister case to Swift that IBM now cites (IBM 1969 Mem. at 7 n.3), United States v. Swift & Co., 1983-1 Trade Cas. (CCH) ¶ 65,250 (N.D. Ill. 1980); the courts, therefore, applied the deferential standard of review that is not applicable in this case. (U.S. Prelim. at 21-24.) Moreover, IBM's contention that the courts did not analyze the likely effects of decree termination is simply wrong; they did so cursorily, but that is because the courts gave weight to the Government's determination that the public interest in competition warranted termination. See, e.g., National Broadcasting Co., 842 F. Supp. at 404 ("[t]he parties have pressed on the court that the competitive position of each of them has been materially changed because of the dramatic changes in the television industry. This certainly must be one of the considerations that must be addressed by any judge considering an amendment to a consent decree, particularly one that addresses the concerns of the FCC and Justice Department considering the competitive status of the parties in today's television market.") (emphasis added).

A. The Language Of The Decree Applies To EDPM To Constrain The Exercise Of Market Power Through The Recurrence Of Anticompetitive Conduct, Irrespective Of IBM's Tabulating Machine Market Position.

Contrary to the plain meaning of the Decree's text and the Supreme Court's disapproval of modifications "in the guise of construing a consent decree," *United States v. ITT Continental Baking Co.*, 420 U.S. 223, 236 n.9 (1975) (citing *Hughes v. United States*, 342 U.S. 353, 357-58 (1952)), IBM asks this Court to terminate the Decree pursuant to a standard that is not included in and cannot be gleaned from the judgment and that ignores the requirement that the Court assess the likely impact of termination on the public's interest in competition. IBM claims that the Decree should be terminated because IBM no longer manufactures tabulating machines (*IBM Prelim.* at 5), because the Decree's application to EDPM is contingent on IBM's position in the tabulating machine industry (*Id.* at 5; 14-15) and because the restrictive practices challenged in the 1952 Case, which are enjoined by the Decree, have not recurred in the computer industry. (*IBM 1969 Mem.* at 10.)^{14/} IBM urges this result despite the fact that *nothing* in the Decree's language or structure supports IBM's reading nor its interpretive methodology of resorting to extrinsic evidence to find such a termination standard in the absence of *any ambiguity* in specific Decree provisions.^{15/} (*U.S. Prelim.* at 7-9.) Searching for an ambiguity where none exists, IBM asserts "[a]lthough it is indisputable that some portions of the Decree 'unambiguously' apply to EDPM, that fact tells us nothing about *why* the Decree was made applicable to EDPM" and thus recourse to extrinsic evidence to distill the "purpose" of the Decree is proper. (*IBM 1969 Mem.* at 13-14) (emphasis in original).

¹⁴ Under this test, the demise of the tabulating industry would entitle IBM to obtain Decree termination simply by showing that competition in computers in the form envisioned by the Decree exists, without regard to the Decree's continuing role in preserving the viability of such competition or the effect of such competition on the prices or quality of products and services demanded by different types of computer users. (*IBM Prelim.* at 16-19; *IBM 1969 Mem.* at 10.) Of course, as we have previously demonstrated, these latter issues can only be addressed in the context of an appropriate market analysis. (*see also U.S. Prelim.* at 24-29.) IBM also seems to argue in the alternative (*IBM 1969 Mem.* at 8-9 & n.5), that the Second Circuit's decision in *Kodak* entitles it to Decree termination solely on the basis of the "changed circumstances" that it described in its *Preliminary Statement* (*IBM Prelim.* at 19-28), once again without regard to whether such "changed circumstances" will prevent judgment

But this newly-minted ambiguity cannot withstand scrutiny by the Decree's language and structure. In seeking to prevent the *recurrence* of anticompetitive conduct in the EDPM industry that IBM had employed in the tabulating industry, the Decree makes plain that it is designed to constrain IBM's exercise of market power in EDPM *through recourse to enjoined practices or failure to do what the Decree requires.*^{16/} This is significant for two reasons. First, it underscores that nothing in the Decree's plain language renders any EDPM injunction dependent on IBM's position in the tabulating industry -- something one would expect if a remedy was designed to prevent or undo leveraging. For instance, there is no Decree language whatsoever enjoining IBM from using its tabulating machine monopoly position to "foreclose competition, [or] to gain a competitive advantage . . ." in the EDPM market, standard leveraging language. *See, e.g., United States v. Griffith, 334 U.S. 100, 107 (1948).*^{17/} *Second, as described above, this Decree seeks to prevent the recurrence of anticompetitive conduct that was*

termination from producing any decrease in competition on the prices or quality of products and services demanded by different types of computer users. Our *Preliminary Statement* also shows that the significance of any "changed circumstances" cannot be properly assessed in the absence of an appropriate market analysis. (*U.S. Prelim.* at 18-21, 24-29.)

¹⁵ IBM apparently agrees that in construing decrees, as in construing contracts, courts normally do not rely on extrinsic evidence in the absence of an ambiguity. (*IBM 1969 Mem.* at 13-14.) *See also United States v. O'Rourke, 943 F.2d 180, 187 (2d Cir. 1991); SEC v. Levine, 881 F.2d 1165, 1179 (2d Cir. 1989).* *Because consent decrees "have many of the attributes of ordinary contracts, they should be construed basically as contracts . . ." ITT Continental Baking. Co., 420 U.S. at 236-37 (1975) (footnote omitted).*

¹⁶ The law is clear that in a contested action, a 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 Res. Inc., 395 U.S. 100, 132 (1969)* (quoting *NLRB v. Express Pub. Co., 312 U.S. 426, 435 (1941)*) (emphasis added). Thus, IBM clearly could have consented to the same or even broader relief with respect to EDPM as that to which it consented for tabulating machines. (*See U.S. Prelim.* at 14 nn.11-12.)

¹⁷ This *Griffith* language was quoted and relied upon by the Second Circuit in *Berkey Photo, Inc. v. Eastman Kodak Co., 603 F.2d at 275.* In *Berkey Photo*, the Court of Appeals recognized the theory of monopoly leveraging, whereby a monopolist uses its power in one market to engage in conduct that falls short of a Sherman Act § 2 attempt to monopolize a second market but which nevertheless permits the monopolist to "gain a competitive advantage in another [market], albeit without an attempt to monopolize the second market." *Id.*

not the focus of the 1969 case and the importance of those provisions in protecting the public interest in competition was not addressed or resolved during the 1969 case.

"[D]ecrees are generally to be interpreted *consistently* with their 'plain meaning' or 'explicit language'." *United States v. American Soc'y of Composers, Authors & Pub.*, 782 F. Supp. 778, 787 (S.D.N.Y. 1991) (emphasis added). To interpret the judgment, we therefore begin with the language itself, because, "the words [of a contract] themselves . . . are always the most important evidence of the parties' intention." *Network Pub. Corp. v. Shapiro*, 895 F.2d 97, 99 (2d Cir. 1990) (quoting *Eddy v. Prudence Bonds Corp.*, 165 F.2d 157,161 (2d Cir. 1947) (Hand, J.)).^{18/} "The primary objective in contract interpretation is to give effect to the intent of the contracting parties as revealed by the language they chose to use." *Sayers v. Rochester Tel. Corp.*, 7 F.3d 1091, 1094 (2d Cir. 1993) (citations and quotation marks omitted).

If IBM's interpretation of the Decree is not supported by the Decree's language, it should be rejected, *ITT Continental Baking. Co.*, 420 U.S. at 234-35, especially in light of the fact that the parties spent almost a year negotiating the settlement. (*IBM Chron.* at 17-25; *U.S. Prelim.* at 15.) See *Grumman Allied Indus., Inc. v. Rohr Indus., Inc.*, 748 F.2d 729, 734 (2d Cir. 1984) ("*[b]*y giving effect to explicit contractual terms, a court has a better chance to carry out the intentions of the parties. Particularly where the two sides are sophisticated, their allocation of risk and potential benefit is properly treated as supreme to any conflicting understanding we may have.")

¹⁸ "[C]ourts will interpret decrees with the same tools as are utilized in the construction of private contracts. This follows from the fact that [a] consent judgment, though it is a judicial decree, is principally an agreement between the parties." *American Soc'y. of Composers, Authors & Pub.*, 782 F. Supp. at 787 (quoting *S.E.C. v. Levine*, 881 F.2d at 1178).

The Decree's language refutes rather than reinforces IBM's unwritten "purpose".

The Decree is replete with references to EDPM and the application of remedies to EDPM is in no way linked to IBM's tabulating machine market position. Indeed, as to Decree Section IV, IBM is flatly wrong that there is "nothing about *why* the Decree was made applicable to EDPM."

(*IBM 1969 Mem.* at 13) (emphasis in original). That Section unambiguously states *why* it applies to EDPM:

[i]t is the purpose of this Section IV of this Final Judgment to *assure to users and prospective users* of IBM tabulating and electronic data processing machines *at any time being offered by IBM* for lease and sale *an opportunity to purchase and own such machines* at prices and upon terms and conditions which shall not be substantially more advantageous to IBM than the lease charges, terms and conditions for such machines. (emphasis added).

Final Judgment § IV. Consistent with the aim of constraining the exercise of market power through lease-only and other anticompetitive practices, Section IV(b)(2) orders IBM "to sell new standard tabulating and electronic data processing machines of each type *at any time thereafter* currently being manufactured and offered for lease or sale by IBM . . ." (emphasis added). This provision plainly is designed to constrain the exercise of market power through the recurrence of discriminatory practices against EDPM purchasers, regardless of IBM's tabulating machine market position. Accepting IBM's imported "leveraging" purpose would read into the Decree a time for termination (i.e., when leveraging no longer could occur) that would necessarily render the "at any time" clause superfluous or meaningless. So rather than avoid a reading that creates surplusage, IBM invites it. And it does so even though courts generally refrain from rendering contractual provisions surplusage or of no effect. *See Rothenberg v. Lincoln Farm Camp, Inc.*, 755 F.2d 1017, 1019 (2d Cir. 1985) ("*an interpretation that gives a reasonable and effective meaning to all the terms of a contract is generally preferred to one that leaves a part unreasonable or of no effect . . .*") (emphasis added). *Cf.* RESTATEMENT (SECOND) OF CONTRACTS § 203 at 93 (comment b); *U.S. 1969* tab 4 ("Since an agreement is interpreted as a whole, it is assumed in the first instance that no part of it is superfluous . . . [W]here an integrated agreement has been negotiated with care and in detail and has been expertly drafted for the particular transaction, an interpretation is very strongly negated if it would render some provisions superfluous.").^{19/}

¹⁹ Other Decree provisions impose contingent obligations on IBM, yet none of them condition any obligation on IBM's position in the tabulating machine industry. For example, Section VI(a) requires IBM to

Decree Sections VI and VII further the objective of constraining the exercise of market power against prospective purchasers by enjoining IBM from discriminating against owners of computers in favor of lessees (Section VI) and by enjoining IBM from requiring "*any purchaser*" of an IBM EDPM to have it repaired or maintained by IBM or to obtain spare parts from IBM (Section VII (c)). IBM also is enjoined from requiring "*any lessee or purchaser*" to disclose to IBM the use to which its computers are put (Section VII (b)). (*See U.S. Prelim.* at 4-5.) Indeed, Section VI, by requiring IBM to sell EDPM machines and parts and subassemblies to end users as well as to "persons engaged in the business of maintaining and repairing such machines", plainly is designed to encourage competition in parts, subassemblies and maintenance, creating aftermarket choice for consumers of IBM EDPM. (*See also* Section VII (d) (2)-(3), which generally prevents IBM from restricting experimentation with IBM computers or alterations in or attachments to its computers.) Again, nothing conditions the application of these provision on IBM's power in tabulating machines. Moreover, the Decree also requires IBM to furnish at reasonable and "nondiscriminatory charges" "*to any owner*" of EDPMs the same technical information documents that it generally provides to its own repair and maintenance employees. (Section IX(b).) And Section IX(c) requires IBM to provide documents pertaining to the operation or application of their computers on a non-discriminatory basis and at reasonable charges to IBM computer lessees and purchasers.

IBM unconvincingly states that the EDPM provisions dealing with compulsory patent licensing (*e.g.* Decree Section XI) are in some unspecified way less restrictive than those provisions applicable to tabulating machines. (*IBM 1969 Mem.* at 12-13 n.8.) Actually, IBM's contention is simply wrong. The Decree's compulsory patent licensing provisions provide identical treatment for tabulating machine and EDPM patents.^{20/} Of course, the fact that the

provide certain services without charge to IBM EDPM purchasers, but only if it also provides such services without charge to lessees of the same types of machines; Section VI(b) requires IBM to provide repair and maintenance service to IBM EDPM owners, but only for "so long ... as" IBM renders such service and only if an owner has not altered the IBM EDPM or attached it to another machine in a manner that renders the provision of repair and maintenance services impractical for IBM personnel with standard training; Section VI(c) requires IBM to provide repair and replacement parts to IBM EDPM purchasers and independent service organizations (ISOs), but only "during the period" when IBM has such parts available for use in its leased machines; and Section IX(b) requires IBM to furnish to IBM EDPM owners certain technical manuals, books of instruction and other documents, but only if it furnishes such materials generally to its own repair and maintenance employees.

²⁰ The Section applies equally to patents relating to tabulating and EDPM machines and systems, and it only provides for different treatment of patents relating to tabulating cards and machines used to produce cards (*e.g.*, "tabulating card machinery" (*see* Section II (b)). One Section cited incorrectly by IBM (Section X) applies neither to tabulating machines nor to EDPMs, but is applicable only to tabulating cards and card producing machinery. Section XIV of the Decree (expired after 5 years), which required IBM to furnish certain technical information to its patent licensees, is the only Decree provision that applies to tabulating machines and not to EDPMs.

Decree specifically required compulsory licensing of EDPM patents at all undermines IBM's "purpose" argument. If this Decree was not concerned with EDPM competition for its own sake, it is difficult to understand why Section XI would be included.

B. IBM's Interpretive Method Fails As A Matter of Law And Is Inconsistent With The Facts.

IBM does not and cannot point to any Decree language that *links or in any way conditions* the Decree's application to EDPMs to IBM's tabulating machine monopoly. Moreover, IBM does not point to any identifiable ambiguity, defined as a word or phrase "capable of more than a single meaning" when viewed objectively. *United Nat'l Ins. v. Waterfront New York Realty Corp.*, 994 F.2d 105, 107 (2d Cir. 1993). Refusing to take the Decree's explicit application to EDPMs at face value in adducing the Decree's purpose (*i.e.*, to constrain the exercise of market power through the recurrence of anticompetitive practices and to create aftermarket choice), IBM injects what it deems "extrinsic evidence", even though that evidence (as we show in the our *Preliminary Statement (U.S. Prelim.* at 11-17) and further demonstrate below) does not support its argument. It contends that because the Decree is *silent* on why it applies to EDPMs, extrinsic evidence must be consulted.

This approach to Decree interpretation ignores the Supreme Court's observation that "it is inappropriate to search for the 'purpose' of a consent decree and construe it on that basis," *ITT Continental Baking.*, 420 U.S. at 235, and shies away from construing "the instrument . . . as it is written, and not as it might have been written . . ." *Id.* at 236 (quoting *United States v. Armour & Co.*, 402 U.S. 673, 682 (1971)). *In contrast to IBM's interpretive method here, in Armour*, the Court relied on the decree's text in rejecting the Government's argument that the decree required a complete separation between the defendant's business and another business. *Id.* at 677-78 (noting that the language of "the decree itself, carefully worked out between the parties in exchange for their right to litigate the issues, does not effect a complete separation, but,

rather, prohibits particular actions and relationships not including the one here in question.")

The court did not engage in a searching inquiry into whether the absence of such a prohibition should be explained by extrinsic evidence: "If the parties had agreed to such a prohibition, they could have chosen language that would have established the sort of prohibition that the Government now seeks . . . language that would have been apt either to create a complete separation or to bar with particularity the sort of transaction involved here was not used." *Id.* at 679-80.^{21/}

Similarly, here, the complete absence of language supporting IBM's tabulating machine "purpose" theory counts heavily against it— especially in light of the fact, as shown above, that such an imported provision would contradict Section IV's express purpose and is neither suggested by nor consistent with any Decree provision. IBM's importation also departs from the practice that "the meaning of the words used" should inform the process of supplying an omitted term.^{22/} See RESTATEMENT (SECOND) OF CONTRACTS § 204 at 98 (comment d.), *U.S.*

²¹ IBM's attempt to distinguish *Armour* -- an enforcement action -- from our situation (a termination proceeding) is unpersuasive, for in either situation a court must discern the meaning of the decree's language. Other than pointing out that *Armour* was an enforcement proceeding (*IBM 1969 Mem.* at 14 n.9), IBM does not suggest or support the argument that the text of a decree should be given *less* weight in a termination proceeding than in an enforcement action. Moreover, *Armour* and its progeny (*e.g., ITT Continental Baking*) have been applied with equal force in decree termination/modification and enforcement proceedings. Compare *Western Elec.*, 900 F.2d at 293 (decree modification/termination) with *United States v. O'Rourke*, 943 F.2d at 186-87 (decree enforcement).

²² Certainly if the purpose of this Decree was to prevent IBM from leveraging into a dominant position in the EDPM market from its tabulating market position, then the parties would have included limiting language such as the language that appeared in the decree in *United States v. United Shoe Mach. Corp.*, 110 F. Supp. 295, 354 (D. Mass. 1953), *aff'd per curiam*, 347 U.S. 521 (1954); see also *United States v. United Shoe Mach. Corp.*, 391 U.S. 244 (1968). The *United Shoe* decree contained a provision allowing either party to file a petition and affidavits with the court, "setting forth the then structure of the shoe machinery market and defendant's power within that market." *Id.* at 246. This provision by its own terms was restricted to "shoe machinery" even though the decree also covered other products such as tacks and nails. (*United Shoe Mach. Corp.*, 110 F. Supp. at 352 ¶¶ 2-3.) Since counsel for IBM were fully aware of the *United Shoe* decree and discussed it at length with Government counsel because it proscribed a lease-only policy (see *May 22, 1955 Wehrmann Mem. (IBM Chron. Author.* tab 24)), counsel for IBM could have sought similar language linking the application of this Decree to the "structure" of the tabulating machine industry and IBM's "power within that market".

Indeed, Decree Section X(d) demonstrates that IBM knew how to negotiate such a provision. Section X(d)

1969 tab 4; *Galli v. Metz*, 973 F.2d 145, 149 (2d Cir. 1992) (when interpreting a contract, the court must consider the entire contract and choose the interpretation which "best accords" with the remainder of the contract).^{23/} Thus rather than reach the common sense and accurate conclusion that the complete absence of language conditioning the remedies of EDPM on IBM's monopoly position in the tabulating machine industry evinces that EDPM remedies *were not meant to be so conditioned*, IBM abandons all proper methods of decree interpretation in a desperate search for ambiguity in the face of clarity.^{24/}

Apart from contradicting the plain language of the Decree, IBM's derived overarching "purpose" is belied by the historical record. For one thing, the "prevent-leveraging-from-tabulating-machine-market-to-EDPM-market purpose" IBM now expounds was never mentioned nor alluded to during the January 25, 1956 hearing before Judge Edelstein. In fact, during that hearing, in which counsel for IBM appeared and spoke, the Government indicated that the Decree requires the compulsory sale of machines (January 25,

allowed IBM to demonstrate to the court that "substantial competitive conditions exist in the manufacture, sale and distribution of tabulating cards" such that the future divestiture of a portion of IBM's tabulating card business was no longer necessary.

²³ Importantly, when the Decree remedies leveraging, it does so with explicit language, not through the "silence" IBM divines. For instance, Section VII(c) prevents IBM from tying its repair and maintenance services or parts to the sale of EDPMs by enjoining IBM from requiring any purchaser of an IBM EDPM "to have it repaired or maintained by IBM or to purchase parts and subassemblies from IBM." This is designed to remedy a form of leveraging (tying), but the relationship is between the EDPMs (the tying product) and repair or maintenance services or parts/subassemblies (the tied products). (*See also* Decree Section XV(b) (enjoining IBM "from conditioning the sale or lease of any standard tabulating or electronic data processing machine upon the purchase or lease of any other standard tabulating or electronic data processing machine . . .").) No such relationship is spelled out or in any way intimated in the Decree between tabulating machines and EDPMs.

²⁴ *See Investors Ins. Co. of Am. v. Dorinco Reinsurance Co.*, 917 F.2d 100, 104 (2d Cir. 1990) ("*[p]arol [evidence] may not be used to create an ambiguity where none exists.*") (citations omitted); *United Nat'l Ins. Co. v. Waterfront New York Realty Corp.* 994 F.2d 105, 108 (2d Cir. 1993) ("[c]ourts may not create an ambiguity where none exists.") (quoting *Ingersoll Milling Mach. Co. v. M/V Bodena*, 829 F.2d 293, 306 (2d Cir. 1987)); *Cf. Hunt Ltd. v. Lifschultz Fast Freight, Inc.*, 889 F.2d 1274, 1277 (2d Cir. 1989) ("*Language whose meaning is otherwise plain does not become ambiguous merely because the parties urge different interpretations in the litigation.*").

1956 Tr. at 61-62; *U.S. Selected Docs.* tab 11) and it provides that the prices to be charged for new machines must have a commercially reasonable relationship to the lease charge for the machine (*Id.* at 63-64). Moreover, Government counsel indicated that the purpose of Section V was to "establish in the United States a used machine market which has never been heretofore" (*Id.* at 69) and that it does so by placing restrictions on IBM from "taking back or acquiring IBM machines." (*Id.* at 68-69.) Consistent with the Decree's language and structure, the Government indicated that Section VI "is also an effort to implement the sales requirements of the machines *and* to establish an independent repair and maintenance service industry regarding those machines." (*Id.* at 70) (emphasis added). And Section VII enjoins the recurrence of anticompetitive leasing practices. (*Id.* at 73-75.)^{25/} Section IX, as counsel for the Government informed the court, relates "to the disclosure of technology" to purchasers and "to any present or prospective independent repair man or maintenance personnel." (*Id.* at 78.)^{26/}

Indeed, during the November 4, 1970 modification proceedings before Judge Edelstein, counsel for IBM acknowledged that "the most drastic relief which was imposed by the consent judgment was the requirement that IBM sell as well as lease equipment, and *the primary purpose of that provision* was that by sale there would be created a second-hand market which, in

²⁵ Documents submitted by IBM are not inconsistent with the Decree's language of preventing the recurrence of anticompetitive practices in the EDPM market so as to prevent or constrain market power. Indeed one Government memorandum indicates that there were indications that in the EDPM industry IBM was employing "*those tactics* which gave it a monopoly in the tabulating field". (*March 30, 1955 Wehrmann, at 5; IBM Chron. Author.* tab 28) (emphasis added). Assistant Attorney General Stanley Barnes stated that the judgment "is designed to encourage the growth of competition in every phase of this important industry, including the manufacture and sale of tabulating and electronic data processing machines, the repair and maintenance of such machines The judgment recognizes the increasing importance of the electronic machines and relief provisions extend to these as well as the tabulating machines" (*January 25, 1956 Department of Justice Press Release at 4; IBM Chron. Author.* tab 56)

²⁶ The Government was concerned that computers would supplant tabulating machines and make "the decree obsolete before it is operative." (September 23, 1955 Tr. at 4 (*U.S. Selected Docs.* tab 9.)) The Government had received information to suggest that computers would completely change the nature of the tabulating business and that IBM was employing the same conduct challenged in the complaint to market computers. (*U.S. Prelim.* at 11-12.)

turn, would create competition with the IBM new equipment." (*U.S. Selected Docs.* tab 15 at 2-3) (emphasis added). Once again, no one alluded to IBM's new-found "purpose". In short, IBM's attempt to connect the continuing viability of the judgment in the computer industry to IBM's position in the tabulating industry is an effort to rewrite the bargain to which it consented. It also is contrary to the historical facts.^{27/}

Moreover, when IBM agreed to the judgment, it waived its right to challenge the sufficiency of the Government's evidence or to insist only on relief that would have been supported by the evidence at trial. *Armour*, 402 U.S. at 682; *see also U.S. Prelim.* at 16-17. As a result, IBM's renewed arguments (*see IBM 1969 Mem.* at 13-20) as to the nature or quality of the Government's evidence and its speculation based on an internal discussion by an individual staff attorney as to whether the Government could or would modify the complaint, are

²⁷ By the time the judgment was negotiated, the IBM executive in charge of the litigation, Thomas J. Watson, Jr., former IBM President and Chief Executive Officer (THOMAS J. WATSON, JR., & P. PETRE, *FATHER SON & CO. MY LIFE AT IBM AND BEYOND* 268-70 (1990)) (hereinafter as "*Father Son*") (*U.S. 1969* tab 5)), had firmly committed IBM's future to computers. IBM counsel described in his opening statement in the 1969 case that in the early 1950's, "IBM Corporation committed the company, the entire company, to electronic data processing." (1969 case, May 20, 1975 Tr. at 166; *see also Id.* at 222; *U.S. 1969* tab 6) In light of the enormous investment in this future (*Father Son* at ix, 257) it is difficult to believe that IBM was cavalier in negotiating the judgment in its application to computers. To the contrary, as we have previously explained, the negotiations continued for many months and IBM initially sought to exclude all computers from the scope of the judgment. (*U.S. Prelim.* at 15.) Although IBM did not prevail on that subject, Watson still believed that the terms of the settlement were "reasonable." (*Father Son* at 386.)

By 1949 Watson moved in earnest to shift the company's resources into computers. Within six years, IBM had expanded its group of engineers and technicians from 500 to well over 4000 (*id.* at 202), and the total number of IBM employees worldwide nearly doubled to over 56,000. (EMERSON W. PUGH, *BUILDING IBM: SHAPING AN INDUSTRY AND ITS TECHNOLOGY* 165) (hereinafter as "*Building IBM*") (*U.S. 1969* tab 7.) IBM put the full weight of its sales force behind computers, unlike Remington Rand (*Father Son* at 241), and it invested "tens of millions in new factories and labs." (*Id.* at ix.) IBM agreed to build a computer for the U.S. Naval Ordnance Laboratory. (*Building IBM* at 161.) By 1956, among other things, IBM also developed the Defense Calculator (IBM 701) and other stored-program computers in the IBM 700 series (*Id.* at 167-77); it developed the IBM 650 Magnetic Drum Calculator, the most popular computer of the 1950s (*Id.* at 180-82); it began working on SAGE, the nation's computerized air defense system, which enabled IBM to build highly automated factories before any of its competitors and to train thousands of new workers in electronics (*Father Son* at 230-33; *see also Building IBM* at 199-219); it had begun work on Project Stretch, which resulted in substantial improvements in core memory and transistors (*Id.* at 233-34); and it had spearheaded numerous computer programming developments and begun programming and testing of the FORTRAN compiler. (*Id.* at 183-96.)

irrelevant.^{28/}

V. THE 1969 CASE SHEDS NO LIGHT ON WHETHER THE DECREE APPLIES TO OPERATING SYSTEM SOFTWARE PRODUCTS

IBM continues to argue that the Decree does not apply to IBM's operating system software products that are necessary for operation, including interoperability, of any particular computer or computer system. (*IBM 1969 Mem.* at 24-25 n.16.) Although IBM makes no showing as to how its software argument pertains to the 1969 case, we nonetheless are constrained to respond.

IBM incorrectly asserts that the Government has included software within the scope of the Decree in order to "gerrymander software based 'markets' for the System/390 and AS/400." (*Id.*; *see also* August 7, 1995, Tr. at 28-29, 31.) We have focused our inquiry on the AS/400 and System/390 product families because our preliminary information raises concern that judgment termination might permit IBM to exercise power in markets for AS/400 or System/390 products or services. (*U.S. Prelim.* at 35-36.) Our preliminary concern is the result of our continuing review of the likely impact of judgment termination under current market conditions. (*U.S. Prelim.* at 20-21; 29 n.30.) This review requires an assessment of whether Decree termination would facilitate IBM's exercise of market power in properly defined markets. (*Id.* at 26-37.) We include within the relevant market products that are reasonably interchangeable by consumers for the same purpose (*Id.* at 27) and assess competitive conditions in the context of

²⁸ There is thus no merit to IBM's contention, based on the internal discussion of one staff attorney, that the Government could not have seriously considered amending the complaint. (*IBM 1969 Mem.* at 20.) In fact, there is no evidence that the discussion in the memo represents the views of the Government or even of the memo's author. The language to which IBM refers is merely a point of discussion. Moreover, we have demonstrated the irrelevance of internal opinions discussed by individual employees without some indication that higher-level personnel with management responsibility endorsed the views. (*U.S. Prelim.* at 16 n.13.) *Cf. United States v. Farley*, 11 F.3d 1385, 1389-91 (7th Cir. 1993) (documents that "reflect an agency's preliminary positions about how to exercise discretion on a policy" are privileged and courts should rely on "official, public interpretations" of regulations because the "views of individual members of the staff are not legally germane.").

current market realities, including lock-in considerations. (*Id.* at 31-33 & n.31; 40-43 & nn.44-45.)

As suggested by this standard antitrust analysis, whether operating system software is covered by the Decree, as the Government contends, has no bearing on whether one product is reasonably interchangeable with another product under current market realities. The defined markets will be the same even if, as IBM contends, the Decree does not apply to operating system software. Although the Decree's scope does not affect the process of market definition, it does affect IBM's overall obligations in the markets for S/390 and AS/400 products and services.

IBM wrongly contends that operating system software is not a "device or attachment" under Decree Section II(f) used primarily in or with an electronic data processing system. That section provides no indication that the words "device or attachment" should be limited to hardware products. Section II(e)'s definition of "electronic data processing system" includes machines that are affirmatively capable of performing certain specified functions, and IBM concedes that computers do not work without software. (*Id.* at 3 n.2.) However, IBM maintains that operating system software is not covered by the Decree because little software existed in 1956. (*IBM Reply Br.* at 8-9.)^{29/} But IBM concedes that an electronic data processing machine, as defined in Section II(f), includes "anything that is part of an 'electronic data processing system'" (as defined in section II(e) (*IBM Chron.* at 27.)) It thus admits that the Decree applies to all IBM hardware and to all forms of peripheral devices (*id.*), even though, just like much of today's software, numerous types of hardware and peripheral devices did not exist in 1956 and even though IBM defended the Government's bundling charges in the 1969 case by pointing out the symbiotic relationship between hardware and software (particularly operating

²⁹ The earliest operating system, the Input/Output System, was designed by General Motors for the IBM 701 in 1953. (M.G. LANE & J.D. MOONEY, A PRACTICAL APPROACH TO OPERATING SYSTEMS 32 (1988); *U.S. 1969* tab 8.)

system software) and how computer functions could be transferred between hardware and software.^{30/} It was precisely these types of related products that the "device or attachment" provision of the Decree encompasses. Limitation of the Decree to hardware not only would contradict the express language of Section II(f), which on its face allows no such limitation, but also would permit IBM to evade the Decree simply by shifting computer functions from hardware to software.

Largely to prevent this type of decree evasion, in an analogous setting, the Court of Appeals for the District of Columbia affirmed the District Court's conclusion, over the Government's objection, that a provision in the AT&T consent decree prohibiting the Bell Operating Companies ("BOCs) from manufacturing "telecommunications equipment" also

³⁰ In defending its policy of giving away software against the Government's illegal bundling charges (see *Plaintiff's Statement of Triable Issues* at 8-11; U.S. 1969 tab) IBM itself provides a compelling articulation of this relationship:

IBM did not and does not now separately price that operating systems programming which is "fundamental to the operation of a system" Such programs are an integral component of any computer and are essential to render it capable of performing any useful task whatsoever.

Moreover, operating system software is intimately intertwined with computer hardware during the design process. System functions are often transferred from hardware to operating systems software and back again in the design process as cost, function and technology evolve. As a practical matter, manufacturers must design an operating system together with their hardware.

If changes occur in the state-of-the-art which permit a more stable dividing line between hardware on the one hand and operating system software on the other hand, it may become practical to supply and price operating system software separately. But given the current state-of-the-art and sophistication, the computer hardware and operating system software are technologically and economically a single product. Customers and manufacturers alike treat the operating system as an integral element of the computer.

(*IBM 1969 Pretrial Br.* at 353; U.S. Selected Docs. tab 33) In fact, IBM explained that both types of products can be designed to perform the same function:

Operating systems are as much a part of a computer as any hardware element. Deciding whether to implement a particular process in hardware, software or firmware is at the heart of computer design.

(*Id.* at 345.)

prohibited the development of software that is integral to telecommunications hardware. *United States v. Western Elec. Co.*, 894 F.2d 1387, 1394 (D.C. Cir. 1990). The Court of Appeals explained:

Indeed, because "firmware" circuitry has largely supplanted the more cumbersome vacuum tubes, wires and switches that formerly comprised the heart of many pieces of telecommunications equipment, the reading of section II(D)(2) urged by the DOJ would leave the BOCs free to perform the most significant design and development functions associated with the manufacture of telecommunications products.

Id.

IBM complains that the Government did not earlier state specifically that operating system software is subject to the Decree, even though the Government had no reason to publicize its interpretation of the judgment until after IBM sought to make the Decree's coverage of software an issue in this litigation. (*IBM Chron.* at 27.) Until that time, as recently as August 24, 1993, IBM had advised the Government that it treated software as if it were covered by the Decree. (*U.S. Prelim.* at 3 n.2.) And for more than 20 years after the judgment was entered, IBM gave away its operating system programs "free of charge." (*Building IBM* at 293; *IBM 1969 Pretrial Br.* at 353.) Under these circumstances, the Government had no reason to expect that anyone would want to buy new or used operating systems.

Indeed, it appears that IBM has a number of different policies with respect to operating system software and the Government cannot know the details of these policies or understand their ramifications under the Decree without further discovery. We are unaware of any complaint that IBM has failed to sell software. We express no opinion at this time on IBM's contention that it would be deprived of its intellectual property rights if it were required to sell software. Indeed, as we noted before (*U.S. Prelim.* at 3-4 n.2), we are sympathetic to IBM's desire to protect its software intellectual property rights, which IBM only began to assert two decades after entry of the Judgment. But we do believe that we are entitled to discovery on

these issues and on how IBM's software policies would change in the event the Decree is terminated.

VI. CONCLUSION

The Court should reject IBM's request for exemption from the *Kodak* market power evaluation simply because the Government once initiated and then dropped an unrelated antitrust suit against it. IBM voluntarily entered into the Decree with the understanding that the Decree would govern its conduct in the computer industry in perpetuity. Under the controlling authority, IBM bears the burden of demonstrating that the Decree has achieved its purpose or that changed circumstances have rendered the Decree incapable of accomplishing its purposes. This showing requires an assessment of current market conditions using standard antitrust analysis.^{31/} The 1969 litigation simply does not speak to, much less resolve, these issues.

Estopping the Government and the Court from analyzing current and future market conditions, then, is the surest road to error. The Decree has established industry rules that have been in effect for almost forty years. In reliance on the judgment, new market participants have emerged and have invested billions of dollars. Consumers may substantially benefit from the competition those participants provide. The truncated proceeding that IBM proposes, in short, is contrary to law and would deny the Court the facts it needs to make a reasoned determination.

³¹ Although IBM's papers of late have been silent as to its views of the relevant geographic and product markets, when it filed this motion IBM set out to prove that the "world-wide information handling industry" is an appropriate antitrust market in which to assess the consequences of Decree termination. (IBM Term. Mem. at 9.)

Accordingly, for the foregoing reasons and the reasons stated in the Government's *Preliminary Statement of Issues*, the United States respectfully submits that the 1969 case is irrelevant to this proceeding, which instead is concerned with determining, through examination of likely market effects, whether termination is now warranted because the 1956 Decree has achieved its purposes or changed circumstances have rendered the Decree incapable of accomplishing its purposes. In order to permit an examination of the relevant issues, the Government urges the Court to approve the investigation plan with the aid of discovery set forth in our *Preliminary Statement*.

October 5, 1995

Respectfully submitted,

Kent Brown (KB-5429)
Sanford M. Adler (SA-7428)
Richard L. Irvine (RI-8783)
Don Allen Resnikoff (DR-2017)
Ian Simmons (IS-7468)
James J. Tierney (JT-7842)

U.S. DEPARTMENT OF JUSTICE
Antitrust Division
Computers & Finance Section
555 4th Street, N.W.
Suite 9901
Washington, DC 20001
(202) 307-6200

CERTIFICATE OF SERVICE

This is to certify that, by agreement of the parties, the United States' Memorandum on the 1969 Case was delivered on October 5, 1995, by facsimile (without attachments) to:

Peter T. Barbur, Esq.
Cravath, Swaine & Moore
Worldwide Plaza
825 Eight Avenue
New York, New York 10019
Fax: (914) 288-4085

and made available (with attachments) for pick-up at the Antitrust Division's New York Field Office, 26 Federal Plaza, Room 3630, New York, New York.

Ian Simmons (IS-7468)