UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

UNITED STATES OF AMERICA,	)	
Plaintiff,	)	Civil Action
- against -	)	No. 72-344 (AGS)
INTERNATIONAL BUSINESS MACHINES CORPORATION,	)	
Defendant.	)	

UNITED STATES' MEMORANDUM IN SUPPORT OF PARTIAL JUDGMENT TERMINATION

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September 11, 1995

I. INTRODUCTION

The government submits this memorandum to explain why, subject to having an opportunity to evaluate public comments, it intends to consent in certain respects to the motion of the defendant, International Business Machines Corporation ("IBM"), to terminate the final judgment entered herein on January 25, 1956, and subsequently amended on January 14, 1963, and December 29, 1970 ("judgment" or "decree"). In the *United States' Preliminary Statement of Issues* ("*U.S. Prelim.*") (filed July 19, 1995), the government stated its intention to support termination of Section V(b)-(c), which governs IBM's obligations to offer for sale to used equipment dealers computers that it obtains in trade; Section VIII, which governs the operation of IBM's service bureau business; and the remainder of the judgment in its application to products and services that are outside the System/360 ... 390 and AS/400 families of products and services.

The government also stated that it would require discovery to determine whether termination of the remainder of the judgment would serve the public interest in competition. (*U.S. Prelim.* at 45-54.) On September 7, 1995, the parties jointly proposed a notice and comment procedure for that portion of IBM's motion to which the government has consented. (*Stipulation dated September 7, 1995*.) A second notice will be issued to solicit public comments on the remainder of IBM's motion after the government has received sufficient information to take a position on the merits. (*Id.*, Exhibit A at 1.)

As discussed in our preliminary statement, when the government consents to termination, the Court should apply a deferential standard in its review of whether termination would serve the public interest. (*U.S. Prelim*. at 21-23.) In particular, the Court's public interest review is limited to whether the government has offered a reasoned and reasonable explanation for its consent. (*Id*.) In this memorandum, we provide such an explanation (without repeating our discussion of the applicable legal

standard, included in our preliminary statement).

II. TERMINATION WOULD NOT PERMIT IBM TO EXERCISE MARKET POWER IN MARKETS FOR PRODUCTS AND SERVICES OUTSIDE THE SYSTEM/360 ... 390 AND AS/400 FAMILIES OF PRODUCTS

Judgment termination would be unlikely to facilitate IBM's exercise of market power in any commercially significant markets for products and services outside the System/360 ... 390 and AS/400 families of products. IBM is not the dominant supplier of personal computers or workstation products. Moreover, current users of these IBM products are not "locked in" (*see U.S. Prelim.* at 29-33, 40-44), and thus are able to switch to alternative products of other suppliers on different computing platforms much more quickly and inexpensively than would appear to be possible for an established AS/400 or System/360 ... 390 user. In short, in markets for products and services other than System/360 ... 390 and AS/400 products and services, the judgment does not constrain IBM from exercising market power.

Consequently, termination of the judgment in its application to such markets would be "suitably tailored to the changed circumstance." *Rufo v. Inmates of the Suffolk County Jail*, 502 U.S. 367, 383, 112 S. Ct. 748, 760 (1992); *see also* (*U.S. Prelim.* 20-21, 29-30, 46.) The purpose of the judgment--to constrain IBM's ability to exercise market power (*U.S. Prelim.* at 6)--has been "fully achieved," *United States v. United Shoe Machinery Corp.*, 391 U.S. 244, 248, 88 S. Ct. 1496, 1499 (1968), in markets outside the AS/400 and System/360 ... 390 families of products. The judgment no longer promotes competition in markets in which termination would be unlikely to facilitate IBM's exercise of market power. *United States v. Eastman Kodak Co.*, No. 94-6190, slip. op. at 33-34 (2d Cir. 1995).

With the proposed termination of the judgment in markets for products and services that are outside the System/360 ... 390 and AS/400 product families, IBM would be subject to the same standards of conduct under the antitrust laws that must be observed by its competitors in those markets.

The proposed termination would not apply to any product or service in which IBM may continue to enjoy market power. The government's investigation of the merits of IBM's motion as it applies to such products and services is continuing.

III. SECTION V(b)-(c) SERVES NO USEFUL PURPOSE

Section V(b)-(c) requires IBM to offer to sell for 60 days, and at no more than certain prices to be determined by a specified formula, used IBM machines that it acquires pursuant to trade-ins or as a credit against sums payable to IBM.[1] These provisions were intended to supplement Section V(a) and other judgment provisions in establishing a market for used machines by requiring IBM to solicit orders from used equipment dealers for the used machines that IBM acquires as trade-ins or as credits against sums payable to it by customers. (January 25, 1956 Tr. at 68-69 (*U.S. Selected Docs.* tab 11).)

Our investigation indicates that these provisions have little practical value today. The provisions appear to do little more than delay IBM for at least 60 days from reselling or otherwise making use of the used IBM machines that it acquires as trade-ins or as credits against sums payable. During that 60 day period, IBM complies with the judgment by publishing offers to sell the machines to used equipment dealers at prices that are generally too high to attract the interest of such dealers. Our evidence indicates that, while other judgment provisions may be important for continued competition in the market for used IBM computers, termination of Section V(b)-(c) would not adversely impact competition in used IBM computers or the competitive viability of used equipment dealers.

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[1] Section V(d) of the judgment was added by amendment in 1970 to permit IBM to exercise its rights and remedies as a secured creditor under the Uniform Commercial Code without violating the remainder of Section V. *United States v. IBM*, 1971 Trade Cas. (CCH) ¶ 73,453 (S.D.N.Y. 1970) (*U.S. Selected Docs.* tab 6).

IV. IBM IS NOT THE DOMINANT SUPPLIER IN ANY MARKET FOR COMPUTER SERVICES AND SECTION VIII HAS ONLY LIMITED APPLICATION TO THE COMPUTER-RELATED SERVICES PROVIDED BY IBM TODAY

1. Explanation and Negotiation of Section VIII

Section VIII of the judgment specifies the conditions under which IBM may participate in the service bureau business, which is defined in Section II(k) as "the preparation with tabulating and/or electronic data processing machines of accounting, statistical and mathematical information and reports for others on a fee basis." In general, Section VIII requires IBM to conduct its service bureau business through a separate subsidiary that is required to charge prices that fairly reflect all expenses properly chargeable to the subsidiary. (*Judgment §* VIII(c)(2).) Section VIII prohibits IBM from providing machines to its service bureau subsidiary except on the same terms and conditions that are available to other service bureaus. (*Id. §* VIII(e).) The Section prohibits the service bureau subsidiary from using "International Business Machines" or "IBM" in its name and from employing any IBM employee or any person to solicit orders for the sale or lease of IBM machines. (*Id*. § VIII(b)(1).) IBM is also required to furnish to other actual or potential participants in the service bureau business copies of pamphlets, books of instruction and other documents that IBM furnishes to its service bureau subsidiary and that relate to the operation and application of IBM machines for service bureau business. (*Id.* § VIII(f).)

During the judgment negotiations, the government initially sought the divestiture of IBM's service bureau business (June 20, 1955 Tr. at 23-24 (*U.S. Selected Docs.* tab 8)), but the parties ultimately agreed to the provisions in Section VIII that permitted IBM to conduct its service bureau business through a separate subsidiary. As the government explained to the Court when the judgment was filed, the purpose of Section VIII "is to place independent service bureaus on the basis of competitive equality with those of IBM, and not have [IBM's service bureaus] sustain a competitive advantage by being indirectly subsidized by the parent corporation." (January 25, 1956 Tr. at 77-78 (*U.S.*

Selected Docs. tab 11); *see also* Department of Justice Press Release of January 25, 1956 at 3 (*IBM's Consent Decree Chronology Authorities ("IBM's Chron. Auth.") tab 56*); Memorandum from William D. Kilgore, Jr. to Stanley N. Barnes of January 17, 1956 , at 3-4 (*IBM's Chron. Auth.* tab 55.)

2. IBM's Exit From and Reentry Into Providing Computer Services

In 1973, the government belatedly obtained the relief it originally sought in the judgment negotiations. At that time, as part of the settlement of Control Data Corporation's antitrust claims against IBM, IBM divested the Service Bureau Corporation to Control Data and agreed not to engage in the service bureau business for six years.

In 1982, IBM once again began to provide computer services when it introduced a new remote computing system, the IBM Information Network, which allowed customers to access a central computer facility to use numerous applications programs and data bases and create and test their own applications programs. (Memorandum for Mr. Baxter (*IBM's Chron. Auth.* tab 119).) IBM continued to expand its computer services business to include a wide range of customer outsourcing services, including computer operations and resource management, application development, network management, disaster recovery services (which serve as stand-by computer services for use in the event of an outage of primary information processing support) and transaction processing. On May 15, 1991, IBM consolidated its computer services business into a separate subsidiary corporation, Integrated Systems Solutions Corporation ("ISSC"), which it states that it operates in compliance with Section VIII of the judgment so that it may "prepare reports on a fee basis for customers under conditions established in the 1956 Consent Decree." (IBM News Release of May 15, 1991 at 2 (Attach 3. to Declaration of James L. Mann of December 19, 1994, Memorandum of Law in Support of Sungard Data Systems Inc.'s and Affiliated Computer Services, Inc.'s Motion to Intervene, Exhibit A ("Mann Decl.")).) IBM reportedly formed ISSC so that it could perform data services such as check clearing and claims

processing and produce reports for customers without risking violation of Section VIII. (*Id.*; *see also* "*IBM puts New Spin on Outsourcing,*" InformationWeek 13 (May 20, 1991) (Attach. 4 to Mann Decl.); letter from Evan R. Chesler to Constance K. Robinson of May 9, 1991 (*IBM's Chron. Auth.* tab 124).)

3. ISSC's Current Market Position

ISSC has grown significantly and become a multi-billion dollar business for IBM. (*See* Mann Decl. ¶ 18.) Considering computer-related services in the aggregate,[2] ISSC has become the second largest provider of computer services; it is also a significant competitor in the provision of several different specific services, such as disaster recovery and facilities management services. There are numerous providers of many computer-related services, while only a few providers for others. We have no information indicating that ISSC is dominant in the supply of any individual service. The demand for computer-related services overall is growing, and ISSC's total revenues account for only a small portion of all revenues for such services. Moreover, as we explain below in Section IV.5, Section VIII of the judgment has only limited application to the computer-related services that IBM supplies today.

4. Termination of Section VIII Would Not Harm Consumers

Section VIII is no longer necessary to foster competition among hardware or software suppliers ("manufacturers") or providers of computer services. At the time the judgment was entered, IBM could employ a service bureau business as a sales device to inform potential new customers about its products, thereby gaining advantage over potentially competing manufacturers. The only significant

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Our inquiry revealed that, in analyzing competition and market structure for computer services, all services should not be lumped together in one product market. Rather, there are different products that range from data or information services (such as Westlaw or Lexis), transaction processing services (such as check processing or claims processing), development of customized applications, systems planning and integration, consulting, disaster recovery services, and facilities management. These products are not interchangeable with one another. Many of the products are highly specialized, and significant expertise and investments in time and money appear to be required to become a viable competitor in offering many of the services.

service bureau company at that time was owned by IBM. Today, consumers of computer-related services have become more sophisticated, and this limits the competitive advantage IBM could gain over competing manufacturers by using a service bureau-style organization as a sales device.

In addition, manufacturers that compete with IBM are better able to offer computer services as marketing devices through the creation of their own computer-related service businesses or by affiliating with independent service providers. Under these circumstances, the advantages that IBM previously gained by subsidizing the operation of its service bureau subsidiary to preempt the available demand for other manufacturers' products have been severely limited.

The possibility that termination of Section VIII could enable IBM to discriminate in favor of ISSC to the disadvantage of independent providers of computer-related services, is of concern only: (1) when ISSC and its computer services rivals both must purchase or lease AS/400 or System/360 ... 390 products or services to remain effective competitors and (2) because IBM may continue to possess market power in one or more AS/400 or System/360 ... 390 products or services.[3] Rival computer services providers could be placed at a cost disadvantage in instances in which both ISSC and its computer services rivals must purchase or lease AS/400 or System/360 ... 390 products or services to remain effective competitors. However, to the extent that the judgment constrains IBM's ability to exercise any market power in the supply of AS/400 and System/360 ... 390 products and services, the surviving provisions will continue to limit IBM's ability to raise its prices for such products or services

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Discrimination in favor of ISSC in the sale of products in which IBM does not have market power would not be a profitable long-run strategy for IBM. IBM could not raise above competitive levels the prices it charges ISSC's competitors for such products because those firms could turn to other vendors. Similarly, IBM could not profitably lower below competitive levels the prices it charges to ISSC for such products. Competition in the sale of the products and computer services that use those products should prevent IBM or ISSC from later raising its prices above competitive levels to recoup the losses it would incur by selling such products to ISSC at less than competitive levels. *See Brook Group LTD. v. Brown & Williamson Tobacco Corp.*, 113 S. Ct. 2578, 2587-88 (1993) (to establish competitive injury from predatory pricing, the alleged predator must be shown to have charged prices below its costs and also to have a reasonable prospect, or a dangerous probability, of recouping its investment in below-cost prices in the form of later monopoly profits).

as a means of handicapping ISSC's rivals in providing computer-related services. Termination of Section VIII could eliminate costs associated with ISSC's compliance with that judgment provision by allowing better coordination between IBM and ISSC. Under current market conditions in which IBM does not appear to be the dominant supplier of any computer-related service, any competitive advantage accruing to ISSC as a result of terminating Section VIII would likely stem primarily from these reduced costs and not from IBM's ability to raise the costs of ISSC's rivals.[4] Therefore, to the extent that Section VIII applies to any of ISSC's computer-related services, termination of the provision would likely enable consumers of such services to benefit from lower prices, and we would be reluctant to impede such competitive benefits. *Brook Group*, 113 S. Ct. at 2588-90.

5. Section VIII's Applicability to IBM's Current Computer-Related Services

Our inquiry revealed that few of the computer-related services provided by ISSC today constitute "service bureau business," as it is defined in the judgment. Unlike the broad definitions in the judgment for "electronic data processing machine" (Judgment § II(f)), and "electronic data processing system" (*Id.* § II(e)), which encompass virtually the full range of IBM's computer hardware and software products (*U.S. Prelim.* at 3 & n.2), the definition for "service bureau business" (Judgment § II(k)), applies very specifically to the "preparation of accounting, statistical, and mathematical information and reports for others on a fee basis." Many of the computer-related services provided by ISSC today do not fit within the definition of "service bureau business." For example, since the definition does not include "alphabetic" information or reports (*cf.* Judgment § II(e)), it does not apply to word processing or the preparation of descriptive reports that do not include accounting, statistical or mathematical information. The definition does not apply to the provision of disaster recovery, or standby, computer services, as

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IBM claims that, because of Section VIII, it charged ISSC over $200 million more for computer hardware and software in 1994 than it could have charged if it had not been required to comply with Section VIII. (*IBM's Preliminary Statement of Issues* at 26.) The government has no information to substantiate this figure.

opposed to services resulting in the actual preparation of information and reports.

Many computer services today involve the provision of consulting or management services that either do not require the preparation of reports on a fee basis or require the preparation of such reports only incidentally to the provision of the overall services. The judgment's definition of service bureau business does not encompass these services.

Soon after the judgment was entered, the government considered how the fee requirement limited the scope of the definition of "service bureau business." The government concluded that IBM's provision of computer services, which included furnishing personnel, facilities and mathematical and programming services, pursuant to a contract with the Office of Naval Research, fell within the judgment's definition of preparing information or reports for others. However, the work did not constitute service bureau business since IBM would not receive a fee for its services and would only be reimbursed in accordance with a schedule in the contract for determining its overall costs. (Letter from Robert A. Bicks to George B. Turner of August 14, 1957 (*IBM's Chron. Auth.* tab 98).)

The government has pursued a broader interpretation of the definition of "service bureau business" in only one situation. In 1968, the government concluded that two time sharing computer services offered by IBM, Call/360 Basic (which allowed for user programming in the BASIC computer language) and Call/360 Datatext (which was an early form of word processing service), were service bureau businesses that IBM could conduct only in a separate subsidiary that operated in compliance with Section VIII. IBM thereafter transferred the services to the Service Bureau Corporation and the government launched an investigation to determine if IBM had priced the services in compliance with Section VIII(c) of the judgment. (*E.g.*, Letter from Harry N. Burgess to George B. Turner of May 22, 1969 at 2-4 (*IBM's Chron. Auth.* tab 117); *IBM's Chronology of the 1956 Consent Decree ("IBM*

Chron.") at 43.)[5] However, the government did not subsequently pursue this expansive interpretation of "service bureau business" after IBM re-entered the computer-related services business in the 1982. When IBM specifically advised the government of its plan to offer with the IBM Information Network similar and more extensive services than Call/360 Basic and Call/360 Datatext (Memorandum for Mr. Baxter (*IBM's Chron. Auth.* tab 119)), the government did not require that IBM offer those services through a separate subsidiary. (*IBM Chron.* at 44.)

In short, Section VIII applies to few of the computer-related services provided by IBM (through ISSC) today, and its termination will be unlikely to have an adverse effect on competition.

The investigation ultimately was deferred in 1971 due to the pending 1969 case (letter from John L. Wilson to C.B. McLaughlin, Jr. of March 8, 1971 *(IBM's Chron. Auth.* tab 117)), and became moot after IBM divested its Service Bureau Corporation in 1973.

III. CONCLUSION

For the foregoing reasons, the government recommends, subject to having an opportunity to consider public comment, that the judgment be terminated in part in the manner described in this memorandum.

Respectfully submitted,

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September 11, 1995

CERTIFICATE OF SERVICE

This is to certify that the United States' Memorandum in Support of Partial Judgment Termination was sent by fax and U.S. Mail, postage prepaid, to the following counsel of record on September 11, 1995:

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