**TABLE OF CONTENTS**

## TABLE OF AUTHORITIES

**CASES**



**STATUTES AND RULES**

**UNITED STATES DISTRICT COURT**
**SOUTHERN DISTRICT OF NEW YORK**

| | | |
|---|---|---|
| **UNITED STATES OF AMERICA,** | ) | |
| Plaintiff, | ) | Civil Action |
| - against - | ) | No. 56-344 (AGS) |
| **INTERNATIONAL BUSINESS MACHINES CORPORATION,** | ) | |
| Defendant. | ) | |

**UNITED STATES' MEMORANDUM IN SUPPORT OF JUDGMENT MODIFICATION**


N. Scott Sacks (NS-6689)
James J. Tierney (JT-7842)
Ian Simmons (IS-7468)

U.S. Department of Justice
Antitrust Division
600 E Street, N.W.
Suite 9500
Washington, D.C. 20530
(202) 307-6132

*Attorneys for Plaintiff United States of America*

David Turetsky
*Deputy Assistant Attorney General*

Rebecca P. Dick
*Deputy Director of Operations*


July 11, 1996

## I. Introduction

The Government has tentatively consented, subject to the evaluation of public comments, to modify the January 25, 1956, Final Judgment entered in this action ("Final Judgment") to sunset, over a five-year period, the remaining provisions that apply to defendant International Business Machines Corporation's ("IBM") AS/400 and System/390 families of products and services. The Government has concluded that a transitional period is necessary to protect the investments of AS/400 and System/390 customers and to protect competitors who have made business investments and decisions in reliance on the Final Judgment. The Government's tentative consent to modify the Final Judgment has been given only after extensive consideration of the equitable and competitive issues raised by IBM's Motion to Terminate. Accordingly, the Government is confident that the proposed sunset periods are "within the reaches of the public interest," the legal standard applicable here.

## II. Procedural Background

The Complaint that lead to the Final Judgment was filed on January 21, 1952.[1/] The Government alleged that IBM had

[1] For details on the purpose and history of the Complaint and Final Judgment, see the *United States' Preliminary Statement of the Issues* (*U.S. Prelim.*)(dated July 19, 1995) and *IBM's*

monopolized, attempted to monopolize and restrained trade in the tabulating industry, in violation of Sections 1 and 2 of the Sherman Act. Among other things, the Complaint alleged that IBM only leased, and refused to sell, tabulating machines. Through its lease agreements, IBM allegedly: charged lessees a single price for machine rental and repair and maintenance; limited machine uses; restricted attachments to, alterations in, or experimentation with such machines; and required grant backs of any inventions resulting from a breach of the prohibition on experimentation. By 1955, IBM had adopted the same lease-only strategy with respect to computers.

The Final Judgment applies to IBM’s conduct with respect to tabulating machines, which IBM has not manufactured for many years, and to computers. Certain provisions of the Final Judgment have expired or no longer apply to IBM's business. Other provisions, however, continue to govern IBM's computer business. On June 13, 1994, IBM filed its Motion seeking the immediate termination of the Final Judgment.

In September 1995, the Government tentatively consented to partial termination. After a public comment period, and upon motion of the Government, the Court on January 17, 1996, found that partial termination was in the public interest and entered an order terminating: (1) Sections V(b) and (c), which required IBM to offer to sell at no more than specified prices and to hold

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*Preliminary Statement of the Issues* and *Chronology of the 1956 Consent Decree* (dated June 6, 1995).

for a specified period used IBM computers that IBM acquired as trade-ins or as a credit; and (2) Section VIII, which specified conditions under which IBM could engage in "service bureau business," as defined by Section II(k) of the Final Judgment. The Court also terminated all other provisions of the Final Judgment as they applied to IBM's computers, other than the AS/400 and System/390 families of products and services.

The Government was permitted a period of time to investigate the likely impact of termination on IBM's AS/400 and System/390 customers and competitors. During the course of its investigation, the Government interviewed more than 100 AS/400 and System/390 customers and dozens of IBM's competitors; reviewed well over 100,000 pages of documents produced by IBM and third parties; deposed seven IBM witnesses; and consulted with in-house and outside economic and technical experts. The Government then weighed all of the evidence. The Government concluded that it could not consent to IBM's Motion seeking the outright termination of the Final Judgment. The Government, however, concluded that it would be appropriate to establish specific sunset periods to permit the gradual phase-out of the Final Judgment.

On July 2, 1996, the parties agreed to modify the Final Judgment to establish specific sunset periods for all provisions that currently apply to IBM's AS/400 and System/390 products and services. The Court on July 2, 1996, entered a Stipulation and Order suspending further proceedings and directing the parties to

submit by July 12, 1996, a proposal for a public comment period on the proposed consensual settlement. The parties today have filed a stipulation and proposed order to implement procedures that will give non-parties notice of, and an opportunity to comment upon, the proposed modification of the Final Judgment. This memorandum sets forth the legal standard governing a court's review of a consensual judgment modification and explains why the Government, subject to having an opportunity to evaluate public comments, has tentatively consented to modification of the judgment in this instance.

## III. The Legal Standard Governing the Court's Public Interest Determination

This Court has jurisdiction to modify the Final Judgment pursuant to Section XIX of the Judgment, Fed. R. Civ. P. 60(b)(5) and (6), and "principles inherent in the jurisdiction of the chancery." *United States v. Swift & Co., 286 U.S. 106, 114 (1932).*

*Where, as here, the Government tentatively consents to the proposed modification of an antitrust judgment, the issue before the Court is whether the modification "is in the public interest." United States v. Loew's Inc., et. al., 783 F. Supp. 211 (S.D.N.Y. 1992). As discussed in our Preliminary Statement, the ultimate question before the Court in this antitrust case is whether modification of the Final Judgment serves the public interest in competition. U.S. Prelim. at 21-24.*

*It has long been recognized that the Government has broad discretion in settling antitrust litigation on terms that will*

*best serve the public interest in competition. See Sam Fox Publishing Co. v. United States, 366 U.S. 683, 689 (1961). In settling a case, the Government may consider the full range of settlements that are consistent with the public interest. See, e.g., United States v. Western Electric Co., 900 F.2d 283, 307-09 (D.C. Cir.), cert. denied sub nom. MCI Communications Corp. v. United States, 498 U.S. 911 (1990). Consequently, when the Government consents to modify a judgment, the Court should accept the proposed settlement absent a clear showing that the Government has abused its prosecutorial discretion. Loew's, 783 F. Supp. at 214; United States v. Mid-American Dairymen, Inc., 1977-1 Trade Cas. ¶ 61,508 at 71,980.*

*The legal standard to be applied in this judgment modification proceeding is the same standard that a district court applies in determining, pursuant to the Tunney Act, whether to enter a consent decree in a government antitrust proceeding. Loew's 783 F. Supp at 213-14; see United States v. Swift & Co., 1975-1 Trade Cas. ¶ 60,201 at 65,702-03. In a Tunney Act proceeding, the reviewing court must determine whether entry of the proposed consent decree "is in the public interest." 15 U.S.C. § 16(e). Under this deferential standard, "the court's function is not to determine whether the resulting array of rights and liabilities is the one that will <u>best</u> serve society, but only to confirm that the resulting settlement is within the <u>reaches</u> of the public interest." United States v. Microsoft Corp., 56 F.3d 1448, 1460 (D.C. Cir. 1995)(emphasis in*

*original)(internal quotations omitted).*

*The Court's role necessarily is limited because an antitrust settlement reflects the Antitrust Division's predictive judgment concerning the efficacy of the proposed settlement or modification and is thus an exercise of prosecutorial discretion. Indeed, courts must bear in mind that antitrust settlements have the virtue of enabling "the Department of Justice to reallocate necessarily limited (enforcement) resources," id., at 1459, and bring the public the certain benefit of some measure of relief when no such certainty exists if the case proceeds to trial.*[2/] *See id. at 1461.*

*Thus, the Court's review to determine whether the parties' consensual modification is "within the reaches of the public interest" must remain narrowly focused. The Court's inquiry should be limited to whether the Government has offered a reasoned and reasonable explanation for its consent, United*

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[2] Though the *Microsoft* court in *dictum* suggests that a district judge must be even more deferential in reviewing "entry of an initial proposed decree" than in reviewing "the parties' request for approval of modification", *Microsoft,* 56 F.3d at 1460-61, the court made clear that stipulated modifications deserve considerable deference from the reviewing court. Indeed, the D.C. Circuit observed that "[u]nder our own precedent dealing with uncontested modifications of a consent decree, we have repeatedly said that a district judge must approve such modifications so long as the proposal falls 'within the reaches of the public interest'." *Id*. at 1457-58 (*citing Western Elec. Co.*, 900 F.2d at 309) (third emphasis in original). And the D.C. Circuit reiterated that the public interest is a flexible one. *Id*. at 1460. Accordingly, "a court should not reject an agreed-upon modification unless it has exceptional confidence that adverse antitrust consequences will result -- perhaps akin to the confidence that would justify a court in overturning the predictive judgments of an administrative agency." *Microsoft,* 56 F.3d at 1460 (citations & internal quotation marks omitted).

*States v. Bechtel Corp., 648 F. 2d 660, 666 (9th Cir.), cert. denied 454 U.S. 1083 (1981), and approval should be granted "so long as the resulting array of rights and obligations is within the zone of settlements consonant with the public interest today." Western Elec. Co., 900 F.2d at 307.; see also United States v. Western Elec Co., 993 F.2d 1572, 1577 (D.C. Cir.) cert. denied sub nom. Consumer Federation of America v. United States, 114 S. Ct. 487 (1993)("court may reject an uncontested modification only if it has exceptional confidence that adverse antitrust consequences will result ...")*

***IV. The Proposed Modification Is In The Public Interest***

*The Government tentatively has concluded, subject to an opportunity to evaluate public comments, that modifying the Final Judgment to establish specific sunset periods for the remaining substantive provisions of the Final Judgment -- Sections IV, V, VI, VII, IX, and XV -- is well within the reaches of the public interest. The Government has concluded that sunsetting the Final Judgment is appropriate given the major changes in the computer industry over the forty years that the Judgment has been in effect and IBM's market position today.*

*Determining the appropriate sunset period requires the consideration of the consequences of termination on the public, including IBM. The Government considered the equitable and competitive interests of AS/400 and System/390 customers and competitors who have made decisions and investments in reliance on the Final Judgment. The Government also considered the costs*

*and inefficiencies allegedly imposed on IBM by some provisions of the Final Judgment and any resulting harm to competition. Added to this analysis were the risks and uncertainty inherent in litigating the complex issues presented by IBM's Motion and the fact that any settlement requires compromise by both parties. Because the consideration of these factors worked out differently for different provisions and different products, the Government has agreed to sunset the Final Judgment in stages over a five-year period. Generally, the Final Judgment as it applies to the AS/400 will sunset in four years and will sunset in five years with respect to the System/390. (A chart summarizing the sunset periods for the AS/400 and System/390 is attached at Tab 1.)*

*The Second Circuit has recognized that should circumstances so warrant, a court properly may exercise its equitable powers to phase-out a final judgment. See United States v. American Cyanamid Co., 719 F.2d 558, 566 (2d Cir. 1983), cert. denied, 465 U.S. 1101 (1984).*

*A. <u>Provisions Subject To Immediate Termination</u>*

*The Government has tentatively consented to terminate Sections IV(b)(3) and (c)(7) and Section VII(d)(1) immediately upon entry of an Order by the Court.*

*Section IV(b)(3), which relates to the sale of "special purpose" computers designed for individual users, can be terminated immediately without adverse impact on competition. Section IV(c)(7), which requires orders to be filled in the order received, can also be terminated immediately. IBM claims that*

*specifying delivery practices in this manner imposes some inflexibility and inefficiencies on its delivery scheduling. We believe that the specificity mandated by this provision is no longer warranted; the general non-discrimination requirement of Section IV(c)(3) is sufficient. Section VII(d)(1), relating to tabulating card purchases, is no longer of any practical effect, and also can be terminated immediately.*

*B. AS/400*

*With respect to the AS/400 family of products and services, the Government has tentatively consented to terminate: (1) Section V(a) immediately upon entry of an order by the Court; (2) Section IV (except Section IV(c)(3) as it applies to operating systems) and Section VI(a) six months after entry of an Order by the Court; and (3) all other provisions of the Final Judgment as they apply to the AS/400, including Section IV(c)(3) as it applies to operating systems, on July 2, 2000. While competition in the markets for AS/400 products and services is generally healthy, it is essential to protect, for equitable reasons, the substantial investments of AS/400 customers and firms providing leasing and maintenance services in reliance on conditions that exist because of the Final Judgment.*

*Section V(a), which the Government tentatively consents to terminate immediately, prohibits IBM from acquiring used equipment except as a trade-in or credit. Immediate termination of Section V(a) to allow IBM greater freedom to acquire used equipment is not likely to interfere substantially with the*

*continuing viability of the used AS/400 market.*

*Section IV(b), and related provisions of Section IV(c) and Section VI(a), to which the Government would consent to a six-month sunset period, requires IBM to sell equipment on terms not substantially more advantageous to IBM than its lease terms, and contains some related requirements. In our judgment, such restrictions are unnecessary to protect customers or the equitable interests of competitors. The Government, however, would subject Section IV(c)(3) to a four-year sunset period to the extent the Section applies to the provision of operating system software. Section IV(c)(3) requires IBM to establish nondiscriminatory terms for the purchase -- as opposed to the lease -- of a computer. The Government contends that Section IV(c)(3) enjoins IBM from discriminating in providing the operating system to both original and subsequent purchasers of IBM equipment.*[3/] *The Government believes that a longer sunset period for Section IV(c)(3) to ensure the availability of the AS/400 operating system is required to protect customer investment in the AS/400 platform.*

*The Government has agreed to sunset the Final Judgment's remaining provisions -- Sections IV(c)(3)(as it applies to*

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[3] Section IV(c)(3) is a key provision for ensuring purchasers of new and used computers access to the operating system on a nondiscriminatory basis. IBM is the only supplier of the operating systems for its computers and therefore an appropriate term for the sale of a computer is access to the operating system. In order to comply with the nondiscrimination requirement of Section IV(c)(3), IBM has had to establish and observe a published price schedule for its operating system software.

*operating system software), VI(b) and (c); VII(b) (c) and (d)(2)-(3); IX (b) and (c); and XV(a) and (b) -- as they apply to the AS/400 on July 2, 2000. Sections VI(b) and (c) require IBM to offer to computer owners at reasonable and nondiscriminatory prices repair and maintenance service and require IBM to offer to computer owners and independent service organizations, at reasonable and nondiscriminatory prices, repair and replacement parts. Sections VII(b) (c) and (d)(2)-(3) restrain IBM from requiring that lessees or purchasers of IBM computers disclose to IBM the uses of such computers; from requiring that purchasers of IBM computers have them maintained by IBM; and generally from prohibiting experimentation with, alterations in or attachments to IBM computers. Sections IX(b) and (c) require IBM to furnish to owners of IBM computers manuals, books of instructions and other documents that IBM furnishes to its own repair and maintenance employees and require IBM to furnish to purchasers and lessees of IBM computers manuals, books of instruction and other documents that pertain to the operation and application of such computers. Finally, Sections XV(a) and (b) enjoin IBM from entering into certain agreements to allocate markets and prohibit IBM from conditioning the sale or lease of one computer product on the purchase or lease of another computer product.*

*A four-year sunset protects the interests of AS/400 customers, giving them a four-year period in which to assess and adjust investments, data processing strategies, and contracts in anticipation of Final Judgment termination. Moreover,*

*competitors in leasing, maintenance services, and plug-compatible equipment will be able to continue to operate their businesses pursuant to the competitive environment created by the Final Judgment for an additional four years. This is a reasonable and sufficient time to protect investments already made and to make business adjustments in anticipation of termination.*

*C. System/390 And The Remainder Of The Final Judgment*

*With respect to the System/390 family of products and services and the remainder of the Final Judgment, the Government has tentatively consented to terminate all provisions on July 2, 2001. The Government's position that all the Final Judgment's substantive provisions -- Sections IV, V, VI, VII, IX and XV -- require a five-year sunset period is premised on its assessment of competitive concerns related to the markets for System/390 products and services and equitable concerns related to customer and competitor reliance on the Judgment.*

*For competitive reasons, a five-year sunset period is necessary to protect the substantial investments of System/390 customers. The Final Judgment continues to constrain the exercise of market power by IBM with respect to System/390 products and services, for those customers with existing applications that must, as a practical matter, be maintained on the System/390 platform for the time being. While increasingly there are alternative platforms to which System/390 customers can migrate, and while they are doing so in increasing numbers, some functions cannot now feasibly be migrated. The number of these*

*functions will diminish in the coming years. Moreover, System/390 customers that do not migrate are not without bargaining power since they also have a variety of other computer needs that they can meet with IBM products or not, depending on the nature of their overall commercial relationship with IBM. A five-year sunset is adequate to permit customers to adjust business plans and contract for protections while the decree acts to constrain IBM's surviving but diminishing market power.*

*Moreover, the substantial equitable interests of customers who have enormous investments in the S/390 platforms at the core of their businesses and the equitable interests of competitors who entered into leasing, maintenance services, and used and plug-compatible businesses in reliance on conditions that exist because of the Final Judgment, would be adequately protected by a five-year sunset. This period would give them time to earn a return on investments already made in reliance on the Final Judgment and to adjust their business strategies to a post-termination marketplace.*

## ***V. Conclusion***

*For the foregoing reasons, the Government recommends, subject to having an opportunity to consider public comments, that the Final Judgment be modified to establish sunset periods in accordance with the timetable described in this memorandum.*

*Respectfully submitted,*

_____
*N. Scott Sacks (NS-6689)*
*James J. Tierney (JT-7842)*
*Ian Simmons (IS-7468)*

***U.S. Department of Justice***
*Antitrust Division*
*600 E Street, N.W.*
*Suite 9500*
*Washington, D.C. 20530*
*(202) 307-6132*

*July 11, 1996*

***CERTIFICATE OF SERVICE***

*This is to certify that the United States' Memorandum in Support of Judgment Modification was sent by Federal Express to the following counsel of record on July 11, 1996:*

*INTERNATIONAL BUSINESS MACHINES CORPORATION*

*Peter T. Barbur, Esq.*
*Cravath, Swaine & Moore*
*Worldwide Plaza*
*825 Eighth Avenue*
*New York, New York 10019-7475*
*Fax: (914) 765-0676*

_____
*James J. Tierney*