

IBM'S RESPONSE TO AAI PAPER ON MAINFRAME ANTITRUST ISSUES

The American Antitrust Institute has published a short paper by Andrew Chin, an Associate Professor at the University of North Carolina School of Law, that advances a stunning proposition: that International Business Machines Corporation (“IBM”) must stand back and let its competitors steal its technology, or else risk liability under the antitrust laws.¹ That remarkable conclusion though turns on a set of facts and body of law that do not exist. That is why the court that recently considered the questions explored in Professor Chin’s paper—as Professor Chin ultimately acknowledges—squarely rejected a lawsuit brought against IBM raising these allegations. Below, we correct some of the more troubling factual and legal errors underlying Professor Chin’s analysis.

It Is Legal and Perfectly Reasonable for IBM Not to Allow Its Competitors to Copy Technology that IBM Itself Developed at Great Expense

IBM was one of the pioneers of “mainframe” systems in the 1960s. By the late 1980s and early 1990s, so-called “distributed servers,” which were offered by Hewlett-Packard and Sun Microsystems, among others, had come to dominate server computing. Customers were increasingly replacing mainframe-hosted applications and workloads with applications that ran on distributed platforms, and choosing to place the vast majority of their new applications on distributed servers. The prognosis for IBM’s mainframes was so bleak that one well-known analyst predicted in the March 1991 issue of *InfoWorld* that the last mainframe would be “unplugged” by March 15, 1996.

But the death of the mainframe proved to be greatly exaggerated. Thanks to a decision to invest billions of dollars in groundbreaking research and development, IBM was able to

¹ See Andrew Chin, *Refusals to License and Installed-Base Opportunism in the Mainframe Computer Industry: The Investigation of IBM*, AM. ANTITRUST INST., Nov. 27, 2009, http://www.antitrustinstitute.org/archives/files/AAI%20White%20Paper%20on%20IBM.11.27_112720091758.pdf.

resuscitate its mainframes and infuse them with new competitive vigor. The end result of that capital-intensive effort was a line of products with new capabilities and improved performance that enabled IBM to compete more effectively with distributed systems.

The IBM mainframe's recent success has not gone unnoticed by IBM's competitors. But rather than compete the old-fashioned way—through capital-intensive research and development—some of these competitors seek a shortcut: steal IBM's technology for themselves by ignoring intellectual property laws.

These competitors—many of them backed by IBM's largest and fiercest competitors such as Microsoft²— want to sell what Professor Chin refers to as “alternative mainframe platforms.” But that is just a euphemism for a mainframe knockoff. These firms seek to offer computer programs that mimic IBM's mainframe computer instruction-set architecture on Intel-based servers as cheap imitations of IBM's mainframe hardware. IBM's mainframe architecture is highly innovative, reflects a huge investment, and is protected by many patents and other intellectual property. Thus, to facilitate their efforts, these competitors demand that IBM give up its patent and other intellectual property rights and provide its technology to them. Needless to say, that is not how antitrust works. The antitrust and intellectual property laws are complementary and designed to promote competition and innovation, not imitation and free-riding.

Further, Professor Chin is simply wrong when he suggests that the IBM patents required by emulator systems cover IBM's operating systems but not the hardware on which they run.

² See, e.g., Press Release, Platform Solutions Inc., Platform Solutions Inc. Closes Series C Round of Funding (Nov. 27, 2007), available at <http://www.reuters.com/article/pressRelease/idUS165589+27-Nov-2007+MW20071127>; Press Release, T3 Techs., Inc., T3 Technologies, Inc. Announces Investment from Microsoft Corporation (Nov. 3, 2008), available at www.t3t.com/pdf/T3_Press_Release_MSFT_investment_2008-11-03.pdf.

The inventions disclosed by the IBM patents are embodied in IBM's mainframe *hardware* as well as its operating systems.

Professor Chin suggests a more benign interpretation of what these so-called “emulator” companies are attempting to do. As he sees things, they want IBM's intellectual property only to “interoperate” with IBM's mainframe system. Not so. IBM already discloses the information needed to interoperate with IBM mainframes—indeed, most mainframe customers use their mainframes in data centers where mainframes, distributed servers, and other technologies co-exist and interact with one another on a continuous basis. But these “emulator” firms seek access to IBM's intellectual property so that they can *copy* it. Not unlike a street vendor selling “Gucci” handbags, they offer customers no new functionality or improved performance; they simply appropriate IBM's innovative technology for themselves and seek to profit from it. Sure, these firms boast of being the “cheap alternative” to the original—just as do street vendors. But that is an easy trick when you can avoid sinking billions of dollars into uncertain research and development and instead just rely on the fruits of someone else's labor. IBM, not surprisingly, is not interested in contributing to such an effort.

Professor Chin is also wrong when he suggests that IBM sought to impose some sort of improper “condition” on its patent licenses (a condition that Professor Chin suggests impacts competition outside the scope of IBM's patents). But there is nothing “conditional” about IBM's refusal to license emulation systems. IBM has simply made a business decision not to license its patents to those parties, without conditions. Moreover, IBM's licensing decisions impact competition only from those computer systems that illegally infringe IBM's patents, and thus

impact competition only within the scope of IBM’s patents. Firms that sell hardware that does not copy IBM’s mainframe architecture are free to compete—and do so.³

Professor Chin goes on to claim that the law is “ambiguous” on the question of whether IBM may freely refuse to license its patents. It’s not. No court has ever found a holder of intellectual property rights liable for an antitrust violation based on its refusal to license patents to a competitor.⁴ Indeed, such refusals are precisely what the patent laws protect. As the Supreme Court has stated, “the essence of a patent grant is the right to exclude others from profiting [from] the patented invention.” *Dawson Chem. Co. v. Rohm & Haas Co.*, 448 U.S. 176, 215, 100 S. Ct. 2601, 2623 (1980);⁵ see also 35 U.S.C. § 271(d) (“No patent owner otherwise entitled to relief for infringement . . . of a patent shall be denied relief or deemed guilty of misuse or illegal extension of the patent right by reason of [the patent owner’s] refus[al] to license or use any rights to the patent.”). As the Federal Circuit stated in *Intergraph Corp. v. Intel Corp.*,⁶ “the antitrust laws do not negate the patentee’s right to exclude others from patent property.” These holdings have been re-affirmed continuously over decades.⁷ The recent New York federal court

³ Professor Chin also makes a number of additional factual errors, including his description of the prior licensing history between IBM and would-be emulators, and in his description of IBM’s software products OS/390 and z/OS. Chin, *supra* note 1, at 8-9. Without going into unnecessary detail, the key point that bears emphasis is that IBM has *never* licensed its intellectual property to a third party for the purpose of building hardware that would emulate IBM’s 64-bit mainframe architecture. Nor has IBM ever promised anyone that it ever would.

⁴ *CSU, LLC v. Xerox Corp. (In re Indep. Serv. Orgs. Antitrust Litig.) (“ISO”)*, 203 F.3d 1322, 1326 (Fed. Cir. 2000) (“There is ‘no reported case in which a court ha[s] imposed antitrust liability for a unilateral refusal to sell or license a patent’” (internal citations omitted)).

⁵ The Supreme Court has followed this principle for more than a century. See, e.g., *Continental Paper Bag Co. v. Eastern Paper Bag Co.*, 210 U.S. 405, 426-30 (1908).

⁶ 195 F.3d 1346, 1362 (Fed. Cir. 1999).

⁷ See *ISO*, 203 F.3d at 1326 (Fed. Cir. 2000) (“[E]ven where it exists, such market power does not impose on the intellectual property owner an obligation to license the use of that property to others.” (internal quotation marks omitted)); *Data Gen. Corp. v. Grumman Sys. Support Corp.*, 36 F.3d 1147, 1187 (1st Cir. 1994) (noting that an IP holder’s “desire to exclude others from its [protected] work is a presumptively valid business justification” for a refusal to license); *Miller Insituform, Inc. v. Insituform of N. Am., Inc.*, 830 F.2d 606, 609 (6th Cir. 1987) (“A patent holder who lawfully acquires a patent cannot be held liable under Section 2 of the Sherman Act for maintaining the monopoly power he lawfully acquired by refusing to license the patent to others.”); *SCM Corp. v. Xerox Corp.*, 645 F.2d 1195, 1206 (2d Cir. 1981) (“where a patent has been lawfully acquired, subsequent conduct permissible under the patent laws cannot trigger any liability under the antitrust laws.”). See also *United States v. Westinghouse Elec.*

decision dismissing T3's lawsuit against IBM, therefore, stands on firm ground—much firmer than the flawed criticism leveled against it by Professor Chin.

So what is the source of this so-called ambiguity? It turns out that Professor Chin's sole reason for finding any "ambiguity" is a lone decision from the Ninth Circuit in *Image Technical Services, Inc. v. Eastman Kodak Co.*⁸ But the case lacks the significance Professor Chin suggests. The court in *Image Technical Services* reaffirmed one of the core concepts of Anglo-American law: that a refusal to license is presumptively lawful. What Professor Chin seizes on is a caveat suggested by the Ninth Circuit's decision: that this presumption could be rebutted by evidence that the IP holder's "true motivation" in refusing to deal was unrelated to any desire to exercise its intellectual property rights (*i.e.*, IP rights were merely a "pretext"). Whatever may be said for the wisdom of this caveat to the settled rule that a patentee may lawfully refuse to license his patented work, it has been adopted by no other circuit court of appeals. Moreover, it surely has no relevance to IBM. After spending billions of dollars to develop its intellectual property, there is nothing pretextual about IBM's decisions not to license these so-called emulators. There is nothing nefarious or improper about that sort of licensing decision. And a rule prohibiting it would make no sense.

The Antitrust Division of the Department of Justice and the Federal Trade Commission—the principal enforcers of U.S. antitrust law—similarly do not believe that a patentee's unilateral and unconditional refusal to license patents is a basis for an antitrust challenge. Professor Chin plays a bit fast and loose when he quotes the Section 2 Report issued by the Antitrust Division of

Corp., 648 F.2d 642, 647 (9th Cir. 1981) (finding no antitrust violation because "Westinghouse has done no more than to license some of its patents and refuse to license others").

⁸ 125 F.3d 1195 (9th Cir. 1997).

the U.S. Department of Justice in 2008⁹—which indicates a favorable view of unilateral refusals to license¹⁰—and then suggests that the new Assistant Attorney General’s decision to withdraw that report “signals a shift” in the Division’s views on patent licensing. There is no evidence that the withdrawal of the Section 2 Report had anything to do with the Division’s views on refusals to license.¹¹ Indeed, the Division and the FTC have on prior occasions jointly stated—in reports that were *not* withdrawn—that a unilateral, unconditional refusal to license IP is not a concern of antitrust law.¹² Moreover, there is good reason that Congress, the courts, and the antitrust agencies have unanimously and consistently respected and protected the IP rights of innovators: Such protection is essential to preserving incentives for future innovation, and to promoting economic growth and the overall competitiveness of U.S. industry.

The IBM Mainframe Is No “Monopoly”

Professor Chin gets it wrong again when he says that IBM enjoys “a monopoly in the worldwide market for mainframe computers” because IBM’s existing mainframe customers are “locked-in” by prohibitive “switching costs.”¹³ There is no such market, and IBM’s mainframe customers are not locked-in.

IBM mainframes face significant competition from distributed servers offered by industry leaders such as Hewlett-Packard and Sun. These servers are the current platform of choice for hosting the great majority of enterprise customers’ applications. Indeed, less than 10% of the

⁹ U.S. DEP’T OF JUSTICE, COMPETITION AND MONOPOLY: SINGLE-FIRM CONDUCT UNDER SECTION 2 OF THE SHERMAN ACT (2008), *available at* <http://www.justice.gov/atr/public/reports/236681.pdf>.

¹⁰ *Id.* at 129 (concluding that “antitrust liability for unilateral, unconditional refusals to deal with rivals should not play a meaningful part in [Sherman Act] section 2 enforcement”).

¹¹ Press Release, U.S. Dep’t of Justice, Justice Department Withdraws Report on Antitrust Monopoly Law (May 11, 2009), *available at* http://www.justice.gov/atr/public/press_releases/2009/245710.pdf.

¹² See U.S. DEP’T OF JUSTICE & FED. TRADE COMM’N, ANTITRUST ENFORCEMENT AND INTELLECTUAL PROPERTY RIGHTS: PROMOTING INNOVATION AND PROTECTING COMPETITION 30 (2007), *available at* <http://www.usdoj.gov/atr/public/hearings/ip/222655.pdf> (“[L]iability for mere unconditional, unilateral refusals to license [patents] will not play a meaningful part in the interface between patent rights and antitrust protections.”).

¹³ Chin, *supra* note 1, at 3.

money spent by customers on computer servers annually is spent on IBM mainframes. Moreover, Professor Chin apparently believes that the Department of Justice, the federal district court in New York, and the Second Circuit Court of Appeals were all wrong when they determined that an ancient IBM consent decree should be terminated. He also conspicuously omits reference to the even more recent decision in *Commercial Data Servers, Inc. v. Int'l Bus. Machines Corp.*¹⁴—where the court explicitly rejected the suggestion that the IBM mainframe could be considered to constitute a relevant market unto itself.

“Switching costs” do not force customers to remain on the mainframe. Any participant in the current server marketplace knows that customers *can* and *do* switch server platforms regularly, including from mainframes. Indeed, IBM’s own competitors advertise their successful migration of hundreds of customers off IBM mainframes.¹⁵ As noted, not too long ago, the pervasive migration from the mainframe prompted a well-known analyst to predict that the last mainframe would be “unplugged” by March 15, 1996.¹⁶ That era has passed, but it remains clear that customers that use IBM mainframes do so not because they *have* to, but because they *want* to—because it is the platform that best suits their needs. Indeed, customers are also migrating *to* the mainframe; IBM recently announced that over 150 customers switched from other platforms to IBM mainframes,¹⁷ which, of course, is also inconsistent with Professor Chin’s assumptions. These are not the actions of a “locked-in” installed base.

¹⁴ 262 F. Supp. 2d 50, 75 (S.D.N.Y. 2003).

¹⁵ See, e.g., Mainframe Migration Alliance, <http://www.mainframemigration.org> (last visited Dec. 10, 2009) (Microsoft-sponsored website describing numerous mainframe migration “success stories”); Press Release, Hewlett-Packard Company, Business Customers Find Mainframe Cost Out of Step with Data Center Budgets (Nov. 10, 2008), available at <http://www.hp.com/hpinfo/newsroom/press/2008/081110a.html> (“HP today announced that more than 250 companies worldwide have migrated to HP Integrity systems from mainframes over the past two years, saving up to 70 percent in operational costs.”).

¹⁶ Stewart Alsop, INFOWORLD, Mar. 1991 (“I predict that the last mainframe will be unplugged on March 15, 1996.”).

¹⁷ IBM Press Release, More Than 5,000 Customers Moved to IBM Systems From HP, Sun and EMC (Nov. 20, 2008), available at <http://www-03.ibm.com/press/us/en/pressrelease/26129.wss>.

Professor Chin is also wrong to suggest that IBM has no ability or interest in gaining new mainframe customers. Indeed, anyone who suggests that IBM is not seeking to grow mainframe use by new and existing customers has not been paying much attention to IBM. IBM has invested billions in its mainframe systems to persuade customers to leave their workloads on the mainframe, to encourage customers to host new applications of all types on the mainframe, and to gain new customers—and that effort is succeeding. IBM has worked to improve the mainframe’s performance and capabilities, and consistently lowered its prices, all in an effort to encourage this growth. IBM does not engage in “installed base opportunism” —and lacks the ability to do so. The reality is just the opposite. There is simply no question that IBM has placed a huge bet on the future vitality of the mainframe platform, and its strategy is built around persuading customers—both new and (especially) existing customers—to use the mainframe in new areas and for new purposes. Charging non-competitive prices to its installed base would completely undermine these objectives.¹⁸

Conclusion

Professor Chin’s analysis is wrong on the facts and wrong on the law. He fails to appreciate the scope of IBM’s intellectual property, or the reasonable—and ordinary—justifications that IBM has for declining to license the unlawful products being sponsored by IBM’s competitors. He fails to acknowledge the critical role of the IP laws in fostering and protecting investments by innovative firms, and why permitting free-riding by firms that have made no such investments would undermine the incentive to innovate. He also suggests that IBM can exert monopoly power over so-called “locked-in customers” due to the customers’

¹⁸ See, e.g., *SMS Sys. Maintenance Servs., Inc. v. Digital Equipment Corp.*, 188 F.3d 11, 22 (1st Dep’t 1999) (“If DEC is to remain the company of choice for its installed base, it cannot rest on its laurels.”).

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supposed inability to migrate and IBM's supposed lack of ability to grow the platform, though even a cursory review of the market reveals those contentions to be untenable.