

# Computer Wars

## Were IBM's Tactics Against Control Data Unfair or Just Tough?

### Documents of Antitrust Suit Dropped by U.S. Describe Company's Policy Debates

#### Quest for the 'Gold Chippers'

By WILLIAM M. CARLEY

Staff Reporter of THE WALL STREET JOURNAL

Thomas Watson Jr. was furious. It was 1963 and rival Control Data Corp. had just officially announced its 6600 system, which seemed to put CDC ahead of IBM in the field of big "super" computers.

"I understand that in the laboratory developing this system there are only 34 people, including the janitor. . . ." the IBM chairman wrote in a caustic memo to his top executives. "Contrasting this modest effort with our own vast development activities, I fail to understand why we have lost our industry leadership position . . . I think top priority should be given to a discussion as to what we are doing wrong and how we should go about changing it immediately."

Mr. Watson's tough response to Control Data and to other competitors in the computer field is a matter of corporate history. It did produce results, although not exactly what he intended. IBM's tactics helped trigger two dozen antitrust suits against the company, including an enormous one brought by the U.S. Department of Justice.

Although IBM has settled or won the suits brought by competitors, the company's conduct—and the government's sudden decision earlier this year to drop its 13-year-suit—continue to be controversial. Today, in federal district court in New York, Judge David Edelstein will hear arguments that he should nullify the Justice Department's decision to drop the case: In a parallel matter, Judge Edelstein will conduct a hearing on June 21 to consider whether William Baxter, the Justice Department official who decided to drop the case, was involved in a conflict of interest because of his past associations with IBM. The Justice Department's own ethics unit also is looking into the Baxter issue.

#### Predatory Pricing?

Another question raised by the judge, who was infuriated by the Justice Department's withdrawal, is whether Tunney Act procedures, which provide for public scrutiny of cases settled by consent decrees, should be applied to the IBM case. The IBM suit was simply dropped, without a consent-decree settlement.

IBM's tactics against Control Data were an important part of the government's case, although the suit also covered alleged unfair competitive maneuvers against other manufacturers of computers and peripheral equipment and against computer-leasing companies. The Justice Department had charged that the Watson memos and other IBM documents and evidence showed that IBM announced new computers prematurely to head off Control Data sales.

The suit also charged that the documents showed that IBM announced these new computers even though the products were expected to produce losses. Even Mr. Baxter, when he announced that he was dropping the case, said that this amounted to a "reasonably credible predatory pricing episode." Predatory pricing occurs when a corporation illegally prices a particular product below cost to try to knock a competitor out of a market.

#### IBM's Response

IBM has responded by vigorously denying any antitrust violations. The company has said that many of its business practices amount only to hard competition that doesn't violate any law. In regard to Control Data, IBM specifically denied making premature product announcements or engaging in below-cost pricing.

Yet the IBM documents, filed by the Justice Department in the New York court, raise interesting questions about the company's moves against Control Data for antitrust lawyers and business historians alike.

The documents portray Mr. Watson demanding of subordinates, including Frank Cary, now chairman of IBM, the reasons why Control Data was doing so well. They also describe battles within IBM, including how the company rushed to introduce its answer to Control Data—the IBM 360-90 computer—despite protests from some IBM staffers that the 90 hadn't been tested adequately. And the documents illustrate how John Opel, now IBM's president, pushed continued marketing of the 90 in the face of growing losses.

IBM's concern over Control Data began mounting in August, 1963, the documents indicate. Harwood Kolsky, a senior scientist at IBM's laboratories in San Jose, Calif., found a "frightening" trend in favor of Control Data while he was temporarily consulting at a potential customer, the Atomic Energy Commission lab at Los Alamos, N.M. In a long memo, he described how friends at the AEC facility were asking: "What's wrong with IBM anyway; is it coming apart at the seams?" And: "You're leaving us no choice but to go to the (Control Data) 6600."

#### Key Customers

Users of super computers, including government labs and universities with top computer programs such as New York University, were considered key customers.

These "two dozen or so 'Gold Chip' customers," Mr. Kolsky wrote in his memo, "are really the fashion setters for thousands of smaller users throughout the industry. People from these installations are the ones that give the majority of the papers at technical societies and are certainly the ones who are the most vocal when it comes to leading crusades towards new concepts and

Continued From First Page

uses of computers. . . . As they go, so go a great many of the less sophisticated but more profitable customers."

To woo them away from Control Data, the IBM scientist urged building an IBM high-speed computer. It should be "a competition-stopper" and "should be deliberately done as a money-loser," the scientist suggested in his memo.

As it turned out, the type of computer Mr. Kolsky was urging was never built. But his memo, at least one version of it, was read by Mr. Watson and it was cited by him at an IBM conference of top executives held at Jenny Lake, a Wyoming resort.

At that meeting, Mr. Watson ordered the company's data-system division to speed up "Project X," under way since 1961. Project X was to produce a computer with twice the capability of Control Data's 6600.

The result was to be IBM's model 90 series of super computers, the answer to Control Data's 6600. "If we can't do better than (Control Data), we had better let someone else take over the business," Mr. Watson stated in a later memo to A.L. Williams, then president of IBM.

As the IBM project gained momentum in 1964, however, some IBM troops began expressing worries over potential losses. According to one company memo, G.F. Kennard, president of the data-systems division, called a meeting of IBM staffers. There he stated that at a sales price of \$4.5 million and based on sales of 26 systems (including a central processing unit and memory), the model 90 computer might run in the red.

Others began worrying that IBM was moving too fast, without enough testing. In a June 25, 1964, memo to Mr. Kennard, G.B. McCarter, head of a product-test unit, wrote that: "Product Test (has) a 'beef' concerning adequacy of our participation in the proposed plan. . . . As the program is now proposed, testing is not sufficient—especially at the subsystem and system level—to be of any significant benefit."

#### Prospects of Red Ink

The drive to launch the 90 continued anyway, with a meeting on June 30, 1964, to consider announcing the system in July. According to an IBM memo recounting the meeting, finance staffers again projected a loss. Others argued that the loss might be trimmed by shifting some costs to research and development budgets. The memo describing the meeting added: "Although there was some disagreement on the point, the financial people say that taking all development costs not attributable to the (model 90) and applying them somewhere else, would still not show a profit on the program." Announcement of the model 90 was put off.

But only temporarily. The drive to launch the product intensified. Frank Cary, then president of the data-processing division, began pushing the 90. In a July 8 memo, he ticked off potential customers, including AEC labs at Los Alamos and Livermore, Calif., New York University and the University of California at Berkeley.

"It is our position that we must offer general availability of the Model 90 System in order to address the needs of this large scale scientific laboratory market segment," he added.

B.O. Evans, a data-systems division vice president, presented a recommendation to a committee of IBM's top management on Aug. 3 calling for a quick announcement of the 90. "Just on principle," Mr. Evans wrote in a memo describing his presentation, "I think it worthwhile to keep the blow torch on CD."

### Time for a Decision

Finally, for a crucial three days—Aug. 10-12—IBM officials huddled almost around the clock trying to reach a decision on the 90. Apparently concerned that too low a price would be an obvious antitrust violation, the IBM men set the price at \$4.38 million, a "legal department price," as one company memo put it. But that was high enough that IBM salesmen doubted that they could meet the goal of 24 computer sales, of which 20 were to be sold domestically by the data-processing division and the remainder overseas by another IBM unit. A memo by L. Robinson, IBM director of scientific computing, described the problem IBM men were facing the night of Aug. 11:

"Mr. Cary summed it up by emphasizing that 'DPD did not feel the quantity of 20 (domestic sales) was impossible, but it did feel it quite unlikely.' The quantity 8 seemed right and 15 was reaching for a reasonable number." A phone call to an IBM vice president for research at 10 p.m. "elaborated from him the statement that he thought the machine unsaleable in the quantity 20 at 4.38."

Reaching the domestic sales goal of 20, however, was critical, because a shortfall might cause major losses. The IBM men were in a quandary. What to do?

"The alternative to the \$4.38 million price or the quantity 20 was no announcement at all. This seemed the worse of the two evils to (another IBM executive) and Cary," the memo continued.

Later that night, there was more bad news on losses. In an analysis completed about 1:15 in the morning, an IBM staffer concluded that even if the sales goal were met, the 90 (processor and memory) would still lose \$26 million.

Despite all this, IBM plunged ahead. The 90 was announced on Aug. 17, 1964.

### A Quality Problem

But there was trouble ahead. The product-test department had firmly dissented from announcing the 90 series. The head of that department, Mr. McCarter, explained in a memo that "There has been no product testing of models I92 and J92 or any of the basic technologies and components, such as circuits. . . . Product test schedules are inadequate. No firm schedules exist. (Only) tentative schedules have been proposed for circuits. . . ."

By 1965, IBM was running into major technical problems on the model 90 machines. For one thing, sometimes the circuits wouldn't work.

Now Mr. Watson was really furious, and the chairman began rattling the IBM chain of command. In April, 1965, he wrote his brother Arthur, an IBM senior vice president, that "I still am concerned that after 2½ years of effort and warning from the competition, we still are second rate here." The next day Arthur wrote to an IBM vice president that "If you analyze our position versus CDC, it is clear that we have been scooped by them in packaging, machine architecture and cost. . . . I do insist that violent, aggressive and new action be taken immediately."

Shortly afterwards, another IBM vice president wrote to the company's director of technology and engineering that "Tom Watson . . . is beside himself because we apparently cannot come up with something that is agreed to be superior to the 6600. He is beginning to feel that there is something drastically wrong in Engineering. You cannot avoid focusing on this problem. . . ."

### Pressure for Sales

IBM's chairman, meanwhile, was also applying pressure to win sales. "Under no conditions can this corporation afford to lose the NASA (National Aeronautics and Space Administration) bid. We must win it even if we have to change our historic profit relationships," he wrote in a note to brother Arthur.

Despite all the pressure, the 90 series project went from bad to worse. By 1966 Thomas Watson was writing to Mr. Cary asking how Control Data could build a computer "which out-performs our biggest . . . and forces us into a very high cost program . . . to match them?" To beat Control Data, IBM had embarked on a risky and costly project, Mr. Cary replied.

Still IBM pushed on, despite rapidly mounting losses. "The result of our model 90 program review on July 19 (1966), was that we recommend that we move ahead with the program," John Opel, then an IBM vice president, wrote in a memo. He added: "We are (now) looking at a loss of \$108.9 (million)."

In the end, IBM did win the NASA bid, and its first model 90 series computer was shipped to the space agency. But delivery, in October, 1967, was nine months late. IBM also fell far short of its goal of 24 computers, selling only 13 of the units. And IBM did lose over \$100 million on the 90 series.

Control Data, meanwhile, sold about 95 of its 6600s and scored a commercial success with the product.

### IBM's Explanation

In a pretrial brief filed in federal court, IBM argued that the 90 series "was in large measure a research project designed to extend the state-of-the-art, and resulting costs and revenues were largely unpredictable." Under some accounting systems, IBM added, costs attributed to the 90 could be allocated to research, particularly because later computers benefited from technical fallout from the 90.

In any case, IBM added, its staff anticipated a small profit, rather than a loss, when it launched the model 90 machines be-

cause they would enhance sales of other IBM products. And, IBM said, the 90 lost money as a commercial product only because it was beaten in the market by CDC and because of development difficulties, not because of an intent to use predatory pricing.

IBM also said in its brief that late delivery of its computer only reflected unanticipated technical difficulties, especially with circuits. That, IBM added, was common in the industry. CDC itself was seven months late with its 6600, IBM noted. IBM also maintains that its product-test department often dissents from announcements and can be overruled.

In a recent interview, an IBM attorney said that an executive like Mr. Opel might urge continuing the model 90 computers because of contractual commitments and because at that point it might have been more costly to halt than to finish the project.

Mr. Baxter, when he announced the termination of the IBM case, said during a press conference that "there is reasonably convincing evidence in the record that IBM made that decision (to launch the 90) knowing that they would lose a substantial amount of money" on the product. But any attempt at predatory pricing failed to knock out Control Data, he noted, and thus IBM wasn't charged with monopolizing the super-computer market. That was one reason, Mr. Baxter said, for dropping the case.

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