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European Commission's Record-Setting Fine on Intel: What It Means For Business

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Executive Summary

On May 13, 2009, the European Commission imposed on Intel the highest fine ever levied (€1.06 billion or approximately $1.45 billion) for a violation of Article 82 of the EC Treaty, which prohibits abusive conduct by dominant firms. The Commission's 542-page decision (which has yet to be released) is likely to be important for several reasons:

(1) The decision implicates controversial issues regarding the permissible use of rebates, discounts, and promotional payments by firms with leading market positions, including the conditions under which such conduct may be deemed an "exclusive dealing arrangement," and in which above-cost pricing conduct may be considered anticompetitive;

(2) Depending on the precise conclusions of the EC's decision, the outcome of Intel's expected appeal, and ongoing U.S. litigation, there is a real prospect of continued and heightened divergence between U.S. and EU law in this area; and

(3) The decision further solidifies the EC's reputation as (a) an attractive venue for complainants seeking redress for dominant firm conduct and (b) an enforcement agency willing to assert jurisdiction against companies and conduct outside its borders.

Background

The Commission's decision follows a lengthy investigation of Intel stemming from complaints first made approximately nine years ago by Intel's primary competitor, AMD. AMD has also initiated private litigation against Intel in the U.S., and the U.S. Federal Trade Commission and New York Attorney General are continuing to investigate Intel's pricing practices.

Intel has also been scrutinized by national competition authorities in Asia. In March 2005, Intel agreed to abide by a JFTC recommendation to modify certain practices, although it did not agree to the JFTC's factual findings or legal conclusions.[1] In June 2008, the Korea Fair Trade Commission fined Intel approximately $25 million for allegedly providing rebates to local OEMs, including Samsung Electronics and Sambo Computer, that were allegedly contingent upon their not purchasing CPUs from AMD.[2] Intel has appealed that decision.

The Commission's Announcement

Alleged Anticompetitive Conduct. According to today's announcement, the Commission has determined that Intel engaged in two forms of conduct that violated the prohibition on abuse of a dominant position under EU competition law. [3]

1. **Conditional Rebates and Payments**. Intel allegedly made "wholly or partially hidden" rebates to computer manufacturers, including Acer, Dell, HP, Lenovo, and NEC, on condition that they would buy all, or almost all, of their microprocessors from Intel -- at least in certain defined segments. Furthermore, Intel also allegedly made payments to a major European consumer electronics chain (Media Markt) on the condition that it would exclusively sell Intel-based PCs.

   According to the Commission, Intel's rebates impaired the ability of rival manufacturers, such as AMD, to compete and innovate, and this led to reduced choice for consumers. The Commission emphasized that its "case is about the **conditions** associated with Intel's rebates and payments, not the rebates and payments themselves." The Commission also claims that Intel attempted to conceal these conditions.

   The Commission further asserts that Intel's pricing policy was unlawful, at least in part, because "for the part of the computer manufacturers' supplies that was up for grabs, a competitor that was just as efficient as Intel would have had to offer a price for its CPUs lower than its costs of producing those CPUs, even if the average price of its CPUs was lower than that of Intel." To illustrate this point, the Commission claims rival chip manufacturer AMD offered one million free CPUs to a computer manufacturer; however, the customer only took 160,000 CPUs because it would have lost the rebate on millions of CPUs purchased from Intel if it had accepted this offer.

2. **Payments to Prevent Sales of Rival Products.** The Commission also stated that Intel made direct payments to computer manufacturers to "halt or delay the launch of" products containing competing microprocessors or put restrictions on the distribution of such products (*e.g.*, sales of AMD - models were restricted to direct channels or to small/medium business customers).

Fine and Remedy. The €1.06 billion fine is the highest fine ever levied on a company for abuse of a dominant position; it is also more than double the second highest fine (€497 million), which was imposed on Microsoft in 2004. In setting the amount, the Commission cited the gravity and duration (five years and three months) of the alleged infringing conduct. It also noted that the fine represents 4.15% of Intel's turnover in 2008, which is less than half the allowable maximum fine, *i.e.*, 10% of annual turnover.

The Commission also announced that it will require Intel to terminate these practices and avoid engaging in "equivalent" practices in the future. The precise contours of the Commission's ordered remedy, however, remain unclear, as the full decision has not yet been released.

Intel's Reaction

Intel President and CEO Paul Otellini issued a statement announcing that the company will appeal the Commission's decision.[4] The statement also noted that Intel believes "the decision is wrong and ignores the reality of a highly competitive microprocessor marketplace," and that "[t]here has been absolutely zero harm to consumers." Intel has also publicly asserted that the Commission has ignored certain exculpatory evidence.

Key Implications of Decision

The key implications of the decision will become more apparent once the Commission's full decision is published and the specific factual and legal conclusions are revealed. Nevertheless, the Commission's announcement indicates that the decision is likely to raise several important and controversial questions for business.

- ***Effects-based or Formalistic Approach?*** While the Commission indicated that it did not apply its 2008 Article 82 Guidance Paper in this case because proceedings were initiated before it was issued, the Commission did note that the decision is "in line with the orientations set out" in the paper, and "includes a rigorous, effects-based analysis." The materials released to date, however, offer little insight or detail on the broader economic impact of Intel's alleged conduct on either rivals or customers. For instance, while the announcement provides several examples of conditional rebates with major computer manufacturers and some general statements about how AMD was deprived of sales opportunities, and customers were deprived of the opportunity to choose AMD products in those situations, there is no discussion of the proportion of the relevant markets from which AMD was purportedly foreclosed, how these arrangements increased AMD's costs, or how they resulted in higher prices for customers or prevented AMD from competing effectively for new sales opportunities.

Unless the full decision provides a more comprehensive economic assessment of the actual impact on rivals' ability to compete in the market, it may give the impression that it relies on a formalistic approach, in which a violation of EC law requires nothing more than demonstrating that an equally efficient rival has been impaired from certain opportunities.

- ***"Conditional" Nature of Rebates and De Facto Exclusivity?*** The Commission's press release notes that it "obtained proof of the existence of many of the conditions found to be illegal in the antitrust decision *even though they were not made explicit in Intel's contracts*." The Commission purports to have found this proof in evidence it collected during its investigation, including e-mails, responses to its requests for information, and statements made by the other companies.

  Intel has denied in U.S. court filings that it entered into any "exclusive dealing" arrangements. It contends that such a condition cannot be inferred since it has not (i) entered into any long-term exclusivity provisions in its contracts or (ii) coerced exclusivity by refusing to deal with customers that purchase from AMD. It claims to have simply won the competitive battle to persuade customers to buy more of its products by offering ordinary discounts based on the volume of orders.

  It remains to be seen what specific evidence the Commission relied on to determine that Intel's rebates were "conditioned" on customers' buying fewer of AMD's products, or not buying them at all. Businesses will need to take note of what conduct may give rise to an inference of a *de facto* exclusive dealing arrangement.

- ***Exclusionary Foreclosure from Above-cost Pricing?*** Interestingly, the Commission appears to have abandoned the claim made in its initial Statement of Objections in July 2007 that Intel engaged in below-cost pricing to strategic customers in the server segment of the market. Instead, the Commission has concluded that Intel's pricing practices would have required an equally efficient competitor to sell below its costs.

  This conclusion also may have important implications for compliance with EU law. It suggests that the Commission has found Intel's prices to be predatorily low or exclusionary by attributing the monetary value of the discounts Intel offered for the "uncontestable" or "must carry" portion of demand for its products to the "contestable" portion, and then asking whether Intel's prices for the contestable portion are below cost or likely to limit a competitor's ability to compete effectively at a minimum level of scale. This theory of harm is discussed in the Guidance Paper, as well as a 2005 Staff Discussion Paper.

  Notably, although this approach is similar to that adopted by the *Peacehealth* decision, and endorsed as a safe harbor by the Section 2 Report issued by the U.S. Antitrust Division under the Bush administration, for evaluating bundled rebates where multiple products are involved, its use to evaluate single-product loyalty discounts has been criticized by some commentators and in the Section 2 report. (The Antitrust Division under the Obama administration has recently withdrawn this report). The primary complaint has been that it may be difficult for firms to follow such a rule and for courts and antitrust agencies to enforce it consistently, as it requires making complex decisions and judgments about what portion of demand is contestable and what minimum level of scale competing firms need to compete effectively.

  Thus, to the extent the Commission's decision embraces this economic theory of harm, firms with leading market positions seeking to avoid future liability under EU competition law may need to undertake a complex legal and economic analysis before implementing a rebate or discount program to ensure that they are not running afoul of the law.

- ***Convergence or Divergence of EU and U.S. Law?*** The resolution of these issues will also reveal whether Article 82 of the EC Treaty and Section 2 of the Sherman Act are applied in a consistent manner. Whether there is convergence or divergence will also depend on (a) the outcome of Intel's appeal of the Commission's decision; (b) the outcome of pending U.S. litigation and agency investigations regarding Intel's practices; and (c) whether the U.S. antitrust agencies under the Obama administration are successful in their stated efforts to enforce Section 2 of the Sherman Act more aggressively than their predecessors.

  Prior U.S. courts that have examined the use of single-product loyalty discounts have generally rejected attempts to find above-cost pricing conduct anticompetitive in the absence of express or de facto exclusive dealing arrangements. At the same time, exclusive dealing arrangements that foreclose competitors have been found to violate both EU and U.S. law. It remains to be seen whether U.S. courts and enforcement agencies will agree with the Commission's assessment of Intel's conduct.|

- ***Extraterritorial Reach of EU Competition Law?*** The Commission's announcement indicated that the decision will oblige Intel "not to engage in any abusive practices that have an effect within the European Economic Area (EEA)." A significant percentage of Intel's production and direct sales of microprocessors likely takes place entirely outside the EU. The Commission's announcement did not provide details on whether it seeks to modify Intel's contracts and course of dealing with OEMs and other customers that are executed and implemented entirely outside of the EEA.

  Notably, the Korean and Japan enforcement actions involving Intel were focused on altering the conditions under which Intel does business with OEMs located in those countries. Moreover, AMD's damage claims against Intel that related to non-U.S. sales of microprocessors were dismissed in the ongoing U.S. litigation. Depending on the breadth of the EC's remedy in this case, there may be some concern among the international antitrust community that the EU is attempting to unilaterally assert its legal standards and jurisdiction over conduct that only has indirect or spill-over effects on trade within the European Community (*i.e.*,on downstream sales by OEMs of PCs that incorporate Intel products).

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[1] Available at: http://www.jftc.go.jp/e-page/pressreleases/2005/March/050308intel.pdf.

[2] Press release available at: http://eng.ftc.go.kr/bbs.do?command=getList&type_cd=18.

[3] *See* Press Release IP/09/745 available at: http://europa.eu/rapid/pressReleasesAction.do?reference=IP/09/745&format=HTML&aged=0&language=EN&guiLanguage=en.

[4] Available at: http://www.intel.com/pressroom/archive/releases/20090513corp.htm?iid=pr1_releasepri_20090513r.
