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Observations on the European Commission's Intel Decision

On September 21, 2009, the European Commission published a provisional non-confidential version of its May 13, 2009 decision finding that Intel Corporation ("Intel") abused its dominant position in the market for central processing units ("CPUs") using the x86 architecture and fining Intel €1.06 billion.[1] The Commission concluded that Intel's abuses were part of a continuous strategy aimed at foreclosing competition from its only significant competitor, Advanced Micro Devices ("AMD").

Based on the facts as determined by the Commission, the decision does not make new law. The case is significant, however, as the Commission's first application to rebate schemes of the methodology outlined in its 2009 Guidance on enforcement priorities in applying Article 82 of the EC Treaty (new Article 102 of the Treaty on the Functioning of the European Union, TFEU) to abusive exclusionary conduct by dominant undertakings (the "Guidance"),[2] and in particular the analysis of the foreclosure effects of anti-competitive rebate schemes.

Unfortunately, the decision reinforces doubts about the practicality of the Commission's methodology for evaluating anti-competitive foreclosure effects. Oddly, moreover, the Commission nowhere makes clear the legal significance of the foreclosure analysis for its decision, although this analysis accounts for about a third of the entire decision.

I. BACKGROUND

Intel is the world's largest semiconductor manufacturer and the developer of the x86 microprocessor architecture. These processors, based on Intel's 80286 chip, which was used in the first IBM personal computers and the first generation of IBM "clones," are the industry-standard CPU for computers designed to use the Windows and Linux operating systems. Since 2000, Intel and AMD have essentially been the only two manufacturers producing x86 CPUs.

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1 European Commission, COMP/37.990, Intel; http://europa.eu/rapid/pressReleasesAction.do?reference=IP/09/745

2 European Commission, Guidance on enforcement priorities in applying Article 82 of the EC Treaty, 2009/C 45/02, available at: http://ec.europa.eu/competition/antitrust/art82/guidance.pdf

The Commission's investigation was triggered by a complaint from AMD submitted in October 2000 and supplemented in November 2003. In May 2004, the Commission carried out unannounced inspections at Intel's facilities and those of its customers, in cooperation with various national competition authorities in the United Kingdom, France, Germany, Italy and Spain.

On July 26, 2006, the Commission issued a Statement of Objections addressing Intel's dealings with five original equipment manufacturers ("OEMs"), namely: Dell, HP, Acer, NEC, and IBM. The investigation continued through 2008, and included inspections at the premises of European PC retailers and further unannounced inspections at Intel's premises. The Commission issued a Supplemental Statement of Objections on July 17, 2008. After the Court of First Instance denied Intel's applications for interim measures and its request for an extension of the deadline to reply to the Commissions' Supplemental Statement of Objections, Intel filed its written submission to the Commission on February 5, 2009.

The Commission adopted its final decision on May 13, 2009. The decision held that Intel engaged in a single and continuous infringement of Article 82 EC from October 2002 until December 2007 and imposed a fine of €1.06 billion.

II. THE DECISION

The Commission's legal and economic assessment of Intel's conduct is divided into four parts: (1) relevant product market, (2) relevant geographic market, (3) dominance and (4) abuse of a dominant position. Section A below briefly discusses the first three points. Section B below focuses on the Commission's finding of abuse, in particular the Commission's analysis of Intel's rebate scheme.

A. THE RELEVANT MARKET AND INTEL'S DOMINANCE

The Commission defined the relevant market as the market for x86 CPUs. Other CPUs were excluded from the relevant market because there was insufficient demand-side and supply-side substitutability. On the demand side, most OEMs did not consider switching from CPUs based on the x86 architecture to non-x86 CPUs, because non-x86 CPUs were not compatible with the Windows PC operating system that runs on the vast majority of desktop and laptop computers. On the supply side, the Commission found that a manufacturer of non-x86 CPUs would need to expend significant time and resources to switch production to the manufacture of x86 CPUs.

The Commission also found that Intel held a dominant position on the relevant market, with market shares of around 80% or more in an overall x86 CPU market and 70% in the sub-markets of x86 CPUs for desktop computers, laptop computers and for server computers throughout the six-year observation period. The Commission also

identified a number of barriers to entry and expansion in the relevant market relating to the nature and the size of investment required (both in terms of research and development and investment in manufacturing facilities), combined with capacity constraints and significant product differentiation, in particular through brands. The Commission found Intel's to be a "must-stock" brand that provided it with additional market power.

B. ABUSE OF INTEL'S DOMINANT POSITION

The Commission found that Intel engaged in two types of abusive conduct: granting rebates conditioned on customers' buying all or almost all of their needs from Intel and "naked restrictions," outright payments to customers in exchange for not using AMD products.

1. Conditional Rebates

a. Traditional analysis

The Commission first analysed Intel's conditional rebates in the traditional way (paras. 926-1001). It held that Intel's conditional rebates represented an abuse of its dominant position under long-standing case law prohibiting exclusivity rebates and fidelity rebates by dominant companies.[3] Although Intel did not operate an overt fidelity rebate system, the Commission found that the level of Intel's rebates was *de facto* conditional upon customers purchasing all or nearly all of their x86 CPUs (at least in certain segments) from Intel and thereby restricted customers' freedom. The Commission considered that the rebates were part of a long-term comprehensive strategy aimed at foreclosing competitors from the market. The Commission cited e-mails and other evidence referring to rebates to OEMs and Media Saturn Holding, Europe's largest PC retailer ("MSH"),[4] as proof that these rebates were conditioned on customers' not (or essentially not) using AMD chips.

b. As-efficient-competitor analysis

Although the Commission found that Intel's rebates were *de facto* conditioned on the customers' agreement to buy all or substantially all of their needs from Intel and that this system constituted an abuse of Intel's dominant position under existing case law, the Commission went on to apply the methodology set out in the Guidance to evaluate the

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3 *See e.g.*, Case 85/76 *Hoffmann-La Roche*, [1979] ECR 461, paragraph 89.

4 MSH is not a direct customer of Intel but purchases computers from the OEMs. MSH received marketing contributions from Intel, which were treated by the Commission as if they were rebates.

capability of Intel's rebates to foreclose a non-dominant competitor that was as efficient as Intel.

i. Application of the test

In the Guidance, the Commission announced that in exercising its prosecutorial discretion to investigate alleged abuses under Article 82 EC, the Commission would give priority to rebate cases in which the dominant company's rebate system is capable of hindering expansion or entry by competitors that are as efficient as the dominant company. In particular, in the case of rebates, the Commission will focus on the question of what price a competitor would have to offer to compensate the customer for the loss of the rebate if the customer switched part of its demand away from the dominant company. The effective price that the competitor would have to match would be the dominant company's normal price less the rebate from the dominant company that the customer would lose by switching. In this regard, the Guidance recognizes the importance of the size of the portion of the customer's requirements that might be switched (referred to as "the relevant range").[5] The smaller this quantity is, the greater the likelihood that the dominant company's rebate will be considered illegal, because the whole of the rebate the customer would lose must be applied to the small quantity, lowering the effective unit price the competitor must offer in order to make a competitive offer. As long as the effective price that the competitor would need to match remains above the dominant firm's costs, an equally efficient competitor would normally be able to compete profitably notwithstanding the rebate. In those circumstances, the rebate would not normally result in anti-competitive foreclosure.

The Commission's "as-efficient-competitor" analysis thus depends on the assessment of a number of elements, each of which appears difficult to establish and was apparently the object of dispute in *Intel*. In particular, the Commission's approach involved the determination of (i) the amount of the rebate granted by Intel for the (near) exclusivity, (ii) the "relevant range" of the customers' demand that AMD could realistically have supplied, and (iii) Intel's relevant costs.

Regarding (i), the Commission never determined the actual amount of the rebate. Rather, it considered that all "or at least a large part" of Intel's rebate was granted in

[5] The Guidance (at 42) notes that in the case of incremental rebates (*i.e.*, rebates that apply only to additional volumes purchased), the relevant range is normally the additional purchase volumes that are eligible for the incremental rebate. For retroactive rebates (*i.e.*, rebates that apply to all volumes purchased from the dominant company during the relevant period of time), the relevant range would need to be established as the amount for which the customer may realistically be willing and able to switch from the dominant company's product (referred to as the "contestable share") and which the competitor would actually be able to supply.

return for fidelity.[6] This ambiguity is surprising, considering that the nature of Intel's rebate system is the basis for the Commission's finding of abuse.

Regarding (ii), in discussing the customers' contestable share of demand as a basis for the establishment of the relevant range for which AMD could have realistically competed, the Commission noted that Intel was an unavoidable trading partner with a "must-stock" product. The Commission observed that, "*[d]ue to Intel's strong brand and long track record, many final customers would not consider switching away from Intel-based computers, even if an AMD-based alternative were offered. The contestable part of the market is thus limited by the fact that AMD-based computers would only be the most attractive product for a sub-segment of all the OEM's ultimate customers.*"[7] In addition, the Commission looked at submissions of Intel's customers and AMD that detailed the rates at which these companies considered it was feasible to increase their supplies from AMD if they wanted to. On this basis, the Commission concluded that the contestable portion of the customers' demand was quite low.[8]

Regarding (iii), the Guidance refers to two different cost measures, average avoidable cost ("AAC", referring essentially to variable costs) and long-run average incremental cost ("LRAIC", referring essentially to average total production cost).[9] In the Decision, the Commission calculated Intel's AAC, *i.e.*, the cost more favorable to Intel.

Based on its analysis of these factors, the Commission determined that the loss of the conditional rebate from Intel, in light of the limited contestable share of customers' demand, would have been such that AMD would have had to offer its CPUs at a price below Intel's costs to be able to compete. In other words, even if AMD were as efficient as Intel, it would not have been able to match Intel's after-rebate price, because the quantities for which AMD could have competed would have been relatively small, and AMD could not have competed with Intel for those quantities without profit sacrifice.

The decision shows not only that the Guidance's "as efficient competitor" analysis is conceptually complicated, but also that it is very difficult to establish all of the facts necessary to apply that analysis. The discussion of these factors in the decision suggests that neither the dominant company itself, nor its customers and competitors, can

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6 *E.g.*, at 280.

7 European Commission, COMP/37.990 Intel, at 1010.

8 Ibid. at 1009-1012, 1202ff., 1339ff., 1473ff., 1551ff.

9 The Guidance (at 43, 44) suggests that where the effective price remains above LRAIC, the rebate should normally not be considered abusive. In contrast, where the effective price was below AAC, the rebate should generally have an exclusionary effect. If the effective price is between LRAIC and AAC, all "other factors" would need to be considered.

realistically use this approach to evaluate a proposed rebate scheme in advance, since the scheme's legality could be determined only with confidential information of both the dominant company (its costs) and individual customers (the contestable portion of their demand), and neither the dominant company nor any customer or competitor will have access to all the required information.[10]

ii. Uncertain relevance of test

In spite of the time and space the Commission dedicated to its as-efficient-competitor analysis (paras. 1002 to 1577, accounting for about one-third of the entire decision), the Commission never really explained the significance of the foreclosure analysis for its decision. The decision describes the foreclosure analysis only as *"one possible way of examining whether exclusivity rebates are capable or likely to cause anticompetitive foreclosure"* (para. 1002), but the Commission had already concluded that Intel's rebates violated Article 82 EC (Article 102 TFEU) under the established case law of the European Courts before proceeding to the foreclosure analysis (para. 1001). Indeed, in discussing the amount of Intel's fine, the Commission stated that *"the as efficient competitor analysis . . . is not relevant for the purpose of deciding whether the Commission should impose a fine or determining its level as it does not relate to the existence of the infringement or to the question whether it was committed intentionally or by negligence, or to its gravity"* under Regulation 1/2003 or the Commission's fining guidelines (para. 1760).

While the Commission recognizes that the as-efficient-competitor analysis suggested in the Guidance does not (and of course cannot) replace the European Courts' case law on exclusionary rebates, the Guidance suggests that the Commission would no longer pursue rebate cases if the test were not met, even if the rebate scheme under investigation would be abusive under established case law. This approach could lead to the counterintuitive result that the Commission would devote extensive resources to assessing whether a rebate scheme would result in foreclosure, but then drop the case even if a dominant company had committed a violation under applicable case law. The legal status of the as-efficient-competitor test would be much clearer if it were addressed specifically by the European Courts. Indeed, the Commission may have devoted so much time to this analysis in the Intel case in the hope that its significance would be evaluated on appeal.

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[10] *See*, Centre for European Policy Studies Task Force Report, Treatment of Exclusionary Abuses under Article 82 of the EC Treaty (2009) pp. 46-58. Temple Lang, John, *Article 82 EC - The Problems and the Solution* (September 3, 2009), FEEM Working Paper No. 65.2009, at 14. Commission officials have suggested that customers who agree to participate in an abusive rebate scheme may violate Article 81 EC (Article 101 TFEU).

c. ***Defenses***

In its defense, Intel claimed that its rebate scheme was required by an objective justification (meeting competition from AMD) and resulted in efficiencies (lower prices, scale economies, production efficiencies, and risk sharing and marketing efficiencies). The Commission rejected both claims:

- The Commission rejected Intel's meeting-competition defense on the ground that Intel's individualized pricing systems conditioned on exclusivity or quasi-exclusivity were not necessary to respond to price competition, and in any case the meeting-competition argument was inconsistent with Intel's claim that AMD's difficulties resulted from capacity limitations and other problems of AMD itself, and not from Intel's conduct.

- The Commission similarly rejected Intel's efficiency defense, noting that Intel failed to demonstrate precise efficiencies, and in any case the Commission did not object to Intel's rebates, which could be justifiable based on cost savings, but on Intel's conditioning those rebates on exclusive or quasi-exclusive purchasing.

Intel also argued that the fine should have been reduced because of the novelty of the as-efficient-competitor analysis. The Commission rejected this argument, noting that "any element of novelty involved in the analysis and its application could only work in Intel's favor" (para. 1771). This observation suggests that the absence of foreclosure effects might be asserted as a defense, though this approach is not suggested in the Guidance and indeed Intel did not assert the absence of foreclosure as a defense under Article 82 EC.

2. Naked Restrictions

The Commission further found that Intel abused its dominant position by restricting the commercialization of specific AMD-based products by forcing its customers to postpone, cancel or restrict their launch in other ways.

a. ***Traditional analysis***

According to established case law, such "naked restrictions" of competition by a dominant company violate Article 82 EC. In *Irish Sugar*, the Court of First Instance (the "CFI") concluded that a dominant undertaking agreeing with a wholesaler and a retailer to swap competing retail products for its own product constituted an abuse.[11] Through

[11] Case T-228/97 *Irish Sugar v Commission*, para. 226.

those swap arrangements, the dominant firm prevented the competitor's brand from being present on the market, since the retailers no longer had competing products. The CFI found that these arrangements undermined the competition that might have been offered by the new product.[12]

The Commission based its finding that Intel engaged in naked restrictions on competition, *inter alia*, on the following communications:

- In an internal Intel e-mail dated September 2003, an Intel executive reported: "good news just came from [a senior Acer executive] that Acer decides to drop AMD K8 [notebook computer] . . . They kept pushing back until today."

- In an internal HP e-mail dated September 24 2004, an HP executive stated: "You can NOT use the commercial AMD line in the [retail distribution] channel in any country, it must [only] be done direct [to consumers]. If you do and we get caught [by Intel] (and we will) the Intel moneys (each month) is gone (they would terminate the deal). The risk is too high."

- In an internal Lenovo e-mail dated September 2006, a Lenovo executive reported that: "[an Intel executive] told us . . . the deal is base[d] on our assumption to not launch AMD NB [notebook] platform . . . Intel deal will not allow us to launch AMD."

b. ***Defenses***

Intel argued that the objective justifications it advanced in defense of its conditional rebates applied *mutatis mutandis* to the naked restrictions identified by the Commission. The Commission rejected this argument, noting that it could not discern any economic justification for such conduct (para. 1676). The Commission concluded that Intel's conduct constituted "recourse to methods different from those governing normal competition" and therefore to an abuse under Article 82 EC (para. 1681).

C. CALCULATION OF THE AMOUNT OF THE FINE

In calculating the amount of Intel's fine, the Commission took into consideration the gravity of the infringement, its duration, and aggravating or mitigating circumstances, as well as Intel's market share of 70% or more in the x86 CPU market during the relevant period. The volumes of such sales in the EEA were also factors in this assessment. As noted, the Commission did not consider the degree of anti-competitive foreclosure to be relevant to the calculation of Intel's fine.

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12 Case T-228/97, *Irish Sugar v Commission*, para. 233.

III. INTEL'S POSITION AND ARGUMENTS ON APPEAL

Intel has appealed the Commission's decision to the CFI and issued a press release detailing some of the arguments that it will raise. Intel argues that the Commission interpreted ambiguous documents in a manner that was consistently adverse to Intel, while labelling documents favorable to Intel as being insufficiently clear, and it contends that other evidence was suppressed.

Intel also asserts that it was not given access to AMD's internal documents, which purportedly would have allowed Intel to defend itself more adequately. It points in particular to the materials produced by AMD in its civil suit against Intel in the U.S. District Court for the District of Delaware. Meanwhile, however, Intel agreed to pay AMD $1.25 billion to settle this litigation.[13]

Additionally, Intel points to the facts that CPU prices fell significantly during the relevant period and that AMD's market share increased substantially at the same time, arguing that this is evidence of a "three way dynamic, where large and powerful OEMs pitted Intel and AMD against each other to obtain the best products for the lowest price on the best terms."[14]

IV. CONCLUSION

Intel is the Commission's first decision dealing with fidelity rebates since it published the Guidance. On the facts as determined by the Commission, *Intel* does not make new law. However, the decision reinforces long-standing concerns about the treatment of fidelity rebates in EU competition law, while failing to allay doubts about how the Commission's effects-based analysis will be applied in practice.

EU law on fidelity and exclusivity rebates has long been criticized for applying a *per se* rule without any economic analysis to determine whether a given rebate scheme actually results in anti-competitive effects. The Guidance was intended to introduce an effects-based analysis grounded in modern economics to the Commission's enforcement of EU law in this area. Of course, in the Guidance, the Commission could not, and did not claim to, reverse the law on rebates and Article 82 EC laid down in the case law of the European courts. Unfortunately, however, *Intel* arguably combines some of the worst elements of the form-based case law of the European courts and the complexity and unworkable aspects of economic theory as set out in the Guidance.

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13 http://www.intel.com/pressroom/archive/releases/2009/20091112corp_a.htm

14 Intel Press Release: Why the European Commission's Intel Decision is Wrong. http://www.intel.com/pressroom/archive/releases/20090513corp.htm

With respect to the formalistic aspects of EU law as set out in the case law of the European courts, the Commission found that Intel's rebate scheme violated Article 82 EC without any analysis of whether scheme actually harmed consumers.

With respect to the effects-based approach promised in the Guidance, the Commission devoted about one-third of the decision to analyzing the foreclosure effects of Intel's rebates based on Intel's costs and the contestable portions of its customers' demand. This analysis was not relevant to the Commission's enforcement priorities, since the Commission made the decision to launch the Intel investigation long before publishing the Guidance, nor was it relevant to the Commission's finding of the abuse by Intel or the amount of Intel's fine.

Indeed, the length and complexity of the Commission's foreclosure analysis suggest that this approach is not effective as a filter to help the Commission allocate scarce enforcement resources, since a full-scale investigation was apparently required simply to apply the test. Similarly, the need for confidential information of the dominant company and its customers suggests that companies will be unable to apply the test to assess the legality of a proposed rebate scheme. Neither the supplier nor the customer – much less competitors -- will normally have access to all the required information.

The Intel decision highlights the fact that the economic approach the Commission sought to bring to Article 82 EC enforcement through the Guidance does not sit easily with Article 82 EC jurisprudence. Since Intel has appealed the decision, the European Courts will have an opportunity to discuss the relevance of the Commission's approach. Indeed, the Commission may have devoted so much time to this aspect of the case – even though it was not clearly relevant to the decision – precisely to invite the European Courts to incorporate elements of the Commission's effects-based analysis into EU jurisprudence.

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If you have any questions, please feel free to contact any of your regular contacts at the firm or any of our partners and counsel listed under Antitrust and Competition under the "Practices" section of our website at http://www.clearygottlieb.com.

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