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Processor Wars Speed Into Court

David Balto, Special to the national law journal

Antitrust laws are the bulwark to a competitive marketplace. Where antitrust enforcement is effective, dominant firms cannot engage in exclusionary practices that dampen the ability of rivalry to emerge and keep the marketplace honest.

In the current economic downturn, antitrust enforcement becomes even more vital to economic growth. Anti-competitive conduct raises the cost of goods, deadens initiative and stifles the emergence of new competitors and new forms of competition. This dampens economic growth.

The most critical antitrust cases involving a dominant firm are the challenges to Intel Corp., the world's leading microprocessor producer. Intel faces a private suit brought by its chief rival, Advanced Micro Devices Inc. (AMD), and government actions or investigations by the state of New York, the Federal Trade Commission (FTC) and competition authorities in the European Union, Korea and Japan.

U.S. antitrust law takes an ambivalent view of the conduct of dominant firms. Enforcers aim to foster competition and make sure the market rewards strong players. However, once a firm acquires dominance, the antitrust laws, as Justice Antonin Scalia has said, are viewed "through a special lens. Behavior that might otherwise not be of concern to the antitrust laws, or that might even be viewed as procompetitive, can take on exclusionary connotations when practiced by a monopolist." **Eastman Kodak Co. v. Image Tech. Servs.**, 504 U.S. 451, 488 (1992) (Scalia, J., dissenting).

Enforcement against dominant firms was the centerpiece of the Clinton administration's antitrust agenda a decade ago, when the Department of Justice successfully prosecuted Microsoft Corp. for exclusionary conduct as the country watched, transfixed, on the nightly news. Unfortunately, during the Bush administration, antitrust enforcement against dominant firms fell to an all-time low. DOJ did not bring a single case against a dominant firm. Even worse, DOJ suggested that in many instances "monopoly is good for competitive health" by filing a series of amicus briefs supporting the positions of dominant firms in antitrust cases.

CORE ISSUES OF 'MICROSOFT' RETURN

The Obama administration must grapple with the proper enforcement policy toward dominant firms, and there is no better place to start than with the FTC's investigation of Intel, in which many core issues from Microsoft have risen again.

Opponents of Intel's conduct claim that the company engages in several exclusionary practices, primarily market-share-based volume discounts that are tiered so that computer manufacturers and retailers are penalized for using rival products. Intel doesn't deny these practices, but it makes several arguments claiming the charges lack a legal foundation.

First, Intel denies having monopoly power in the intensely competitive microprocessor market. Second, it claims that its only questionable conduct amounted to price cuts, which are per se lawful. Third, it suggests that AMD's market success shows there was no harm from any type of exclusionary conduct. Finally, it suggests that the arrangements did not meet various legal requirements for a cognizable exclusivity claim.

Intel suggests that, despite its 80 percent market share, it lacks monopoly power. It points to both rapid innovation in the market and the fact that microprocessor prices have fallen by 40 percent since 2000. It also notes that its customers involve large and powerful computer manufacturers and retailers. These trends, Intel argues, show a healthy industry, characterized in one brief as "the exact opposite of a market plagued by a stagnant monopoly."

Although Intel's observations about the nature of competition have some merit, they do not answer the fundamental question concerning Intel's monopoly power. Intel has had an 80 percent market share for several years, and the microprocessor market has very substantial entry barriers. Only AMD has been able to successfully stay in the market, and evidence suggests that Intel's practices have denied AMD access to necessary customers, thereby dampening innovation. Moreover, decreasing prices -- especially in a market with rapidly diminishing prices -- do not prove a lack of monopoly power. Absent Intel's exclusionary conduct, prices may have fallen even more rapidly.

Intel attempts to categorize all of its conduct as simple price cuts, and for good reason. The U.S. Supreme Court has said "cutting prices in order to increase business often is the very essence of competition." **Matsushita Elec. Indus. Co. v. Zenith Radio Corp**., 475 U.S. 574, 594 (1986). Intel suggests that all of its conduct must meet the standards of demonstrating illegal predatory pricing -- clever, since predatory pricing cases rarely succeed. A successful challenger would have to show that Intel's microprocessors are sold below cost, and that Intel could recoup those lost profits after their rivals exit.

Intel's arguments are appealing. However, a predatory-pricing standard seems particularly inapt in the rapidly changing microprocessor market, in which costs have fallen significantly and the highest-end product from two years ago may cost less than $100 today. Moreover, the case is not a simple price-discount case. It is an exclusive-dealing case. Intel's tiered volume discounts coerce buyers to purchase the vast majority of their products from Intel and prohibit computer manufacturers and retailers from handling both Intel's and AMD's products. To categorize these practices as mere price discounts is misleading; they are loyalty discounts in which buyers sacrifice choice and consumers may pay more.

Courts have also been reluctant to take a "one size fits all" approach to conduct involving pricing. For example, in **U.S. v. Dentsply**, 399 F.3d 181, 185 (3d Cir. 2005), the 3d U.S. Circuit Court of Appeals rejected the arguments that de facto exclusive-dealing practices were simply price discounts. The court found that these practices were "designed expressly to exclude its rivals from access to dealers" and from attaining a sustainable level of sales. See also **LePage's Inc. v. 3M**, 324 F.3d 141, 159) (3d Cir. 2003). Thus, courts have declined to apply predatory pricing rules to various forms of conduct even when prices are the critical factor. **Cascade Health Solutions v. PeaceHealth**, 515 F.3d 883, 897 (9th Cir. 2008).

Intel argues that its practices cannot be exclusionary because AMD has succeeded in the marketplace. But a rival's success is not dispositive in an antitrust case. Microsoft made similar arguments in its battle with the Justice Department, noting that Netscape and other rivals were growing in the market. But the operative question is not whether rivals have prospered, but whether competition would have been more vigorous but for the anti-competitive conduct. See **U.S. v. Microsoft**, 253 F.3d 34, 64 (D.C. Cir. 2001). AMD's growth presents no legal bar to an antitrust challenge.

Intel argues that various legal requirements for a cognizable exclusivity claim are not met. Specifically, it notes that the contracts may be verbal, short-term or not 100% exclusive and that AMD has alternative distribution mechanisms. Hard-and-fast bright-line rules are desirable in many legal contexts, but in antitrust cases the courts appropriately eschew the use of legal formalism. In addition, courts have rejected dominant firms' argument that an actual written agreement is necessary or that the agreement must be long term to constitute an antitrust violation. **Dentsply**, 399 F.3d at 181; **LePage's**, 324 F.3d at 158. Instead, courts consider the impact of the totality of the defendant's conduct and whether it inhibited the ability of rival firms to compete by keeping them from reaching efficient scale -- in other words, it is the "practical effect" of an arrangement, and not specific technical requirements, that matter in determining illegality. **Tampa Electric Co. v. Nashville Co.**, 365 U.S. 320, 327 (1961).

Even if other manufacturers or retailers are available to distribute AMD products, that does not end the inquiry. For example, in **Dentsply**, the 3d Circuit concluded that a dominant artificial-tooth manufacturer's exclusivity agreements with key dealers harmed competition by keeping its competitors' sales from posing a genuine threat to the monopolist's overwhelming share of the market. The court instructed that the "test is not total foreclosure, but whether the challenged practices bar a substantial number of rivals or severely restrict the market's ambit." Similarly, in the **Microsoft** case, the court held that exclusion from certain key, cost-efficient manufacturers was exclusionary even though other forms of distribution were available. As former Judge Robert Bork observed more than 30 years ago, "By disturbing optimal distribution patterns one rival can impose costs upon another, that is, force the other to accept the higher costs." See Robert Bork, **The Antitrust Paradox** 156 (1978).

THE IMPORTANCE OF THE FTC's INVESTIGATION

Some may ask why the FTC should investigate the conduct in this case, since there is massive private litigation and numerous investigations by other government enforcers. There are several reasons why this matter should be at the top of the Obama FTC's enforcement agenda. First, the market and amount of commerce involved is substantial -- and spurring rivalry will in turn lead to greater competition and output. Second, the FTC's administrative litigation process typically works much faster than federal court litigation. Third, to the extent that the issues involved are complex and sophisticated, the FTC's economic and legal expertise may be just the right tools.

Finally, the fact that numerous foreign jurisdictions are investigating the conduct makes FTC involvement even more vital. The FTC works extensively with foreign antitrust authorities, and this coordination effort may lead to a truly "global settlement" that will be good not only for the market and consumers, but also Intel itself. Perhaps this is the case with which the U.S. antitrust authorities can take the lead in providing a sound rule of law for the conduct of dominant firms.

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