



Abusive behaviour by dominant companies

The Intel and Microsoft cases

Kris Dekeyser *

DG Competition, European Commission

**All views expressed are personal and do not necessarily reflect the official position of the European Commission*



Outline

- The Intel Case : abusive pricing practices
- The Microsoft Cases : refusal to supply and tying abuses



Why intervene?

- Competition for the market *vs* competition in the market
- Specifics of the IT sector
 - High R&D costs
 - Interoperability
 - Lock-in due to network effects and switching costs



The Microsoft Cases

**Refusal to supply and tying
abuses**



Microsoft I

- Very serious antitrust infringement - two abuses:
 - Refusal to supply interoperability information
 - Tying Windows Media Player to Windows
- Fine of 497 million Euro confirmed
- CFI upheld all substantive findings of Commission Decision

Microsoft II

- Tying of web browser Internet explorer to the dominant Windows operating system
- Commitments offered by Microsoft to solve concerns

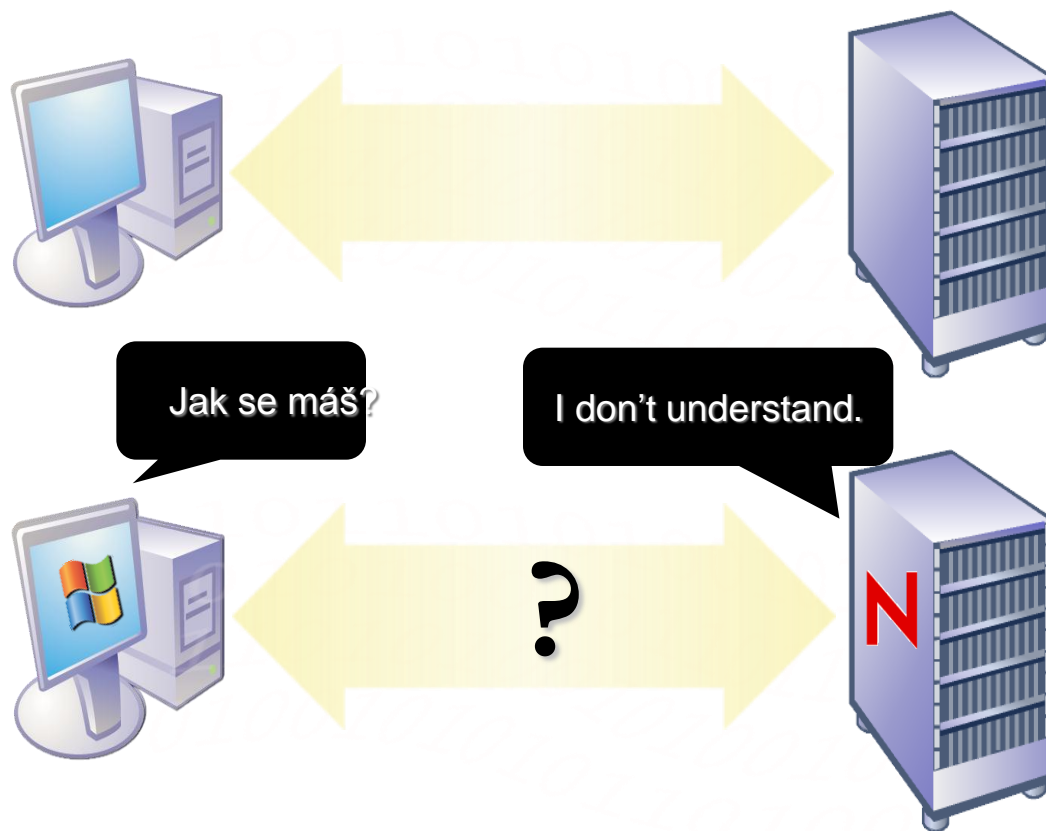


Microsoft I case on refusal to supply

- Microsoft dominant in the PC operating system market, as well as in the work group server operating system market
- In order to develop and distribute products on the market for servers, interoperability with Microsoft PCs is essential
 - Computers do not function in isolation : "As the Windows operating system is present on virtually all client PCs installed within organisations, non-Windows work group server operating systems cannot continue to be marketed if they are incapable of achieving a high degree of interoperability with Windows" (§ 388)
- Microsoft refuses to supply interoperability information between SUN's work group servers and Windows PCs
- No viable alternatives to the information



What is “interoperability”?





Microsoft's arguments

- Interoperability information is IP protected (Patents, Copyright, Trade Secrets)
- Other means to ensure interoperability (reverse engineering)
- There is competition in work group servers (Linux)
- Competitors would “clone” Microsoft's products
- Damage to incentives to innovate



The legal test of the CFI

- Follows a long line of consistent case-law on refusal to supply
- Refusal relates to products/service (here information) which is **indispensable** to the exercise of particular activity on neighboring market (computers do not function in isolation ; no viable alternative to the information)
- Refusal of such kind as to **exclude/eliminate any effective competition**
- Refusal **blocks emergence of new product** for which there is (potential) consumer demand
- No objective justification
 - Intellectual property in itself cannot be a justification (would be contradiction)
 - No reduction in Microsoft's incentives to innovate: rivals can't copy/clone Microsoft's products; aim of decision is interoperability; disclosures are industry practice



The remedy

- Commission decision 2004 (confirmed by CFI in 2007)
 - Imposing fine of EUR 497 million
 - Ordering Microsoft to disclose “Interoperability Information” on reasonable and non-discriminatory terms to vendors of work group server operating system products (trustee)
- Penalty Payment Decision of 12 July 2006
 - Incomplete and inaccurate Interoperability Information
 - Daily penalties (Dec 2005- June 2006): total EUR 280.5 million
- Penalty Payment Decision of 27 February 2008
 - Reasonable Pricing of the Interoperability Information
 - Daily penalties (June 2006- Oct 2007): total EUR 899 million



Competition





A precedent for Microsoft ?

- Microsoft's CEO Steve Ballmer confirmed the benefits of interoperability disclosures:

(Herald Tribune, 3 March 2008)

- *"[...] what we are permitting is more innovation around our products, more interoperability, maybe also more potential for third parties to cannibalize what could have been Microsoft business," [...] "But it is a path we have committed ourselves to because we think it is good for customers and is consistent with our legal obligations."*



A precedent for Article 102 enforcement?

- Generally, freedom to choose partners
 - Reflects ‘exceptional circumstances’ test
- Objective necessity of input to compete downstream
- Likely elimination of effective competition downstream
- Likely to lead to consumer harm
- No objective justification



A precedent for the software industry?

- Negative impact of proprietary de facto standards
 - Imposed on the industry by a dominant company or agreements between competitors (undisclosed technology ; inaccessible IPR)
 - Possible negative effects on competition
 - Lack of interoperability
 - Lock-in due to network effects and switching costs (high barrier to entry)
 - Negative impact on innovation and consumer choice
- Benefits of “Open Standards”



Conclusions on Microsoft 'Refusal to supply' case

- The case is important for the software industry
 - But not for every company in every industry
 - Precise factual analysis relating to specific circumstances (Microsoft is super dominant and can create de facto standards)
- Misleading to claim that the 'floodgates' will open after Microsoft
- Compliance delivered real benefits: open source product designers benefit from interoperability disclosures, which boosts competition and innovation
- Competition must always be assessed on the merits of the products
 - Consumer choice and innovation are key, particularly in the IT sector



The tying abuse in Microsoft II

- Microsoft holds a dominant position on the PC OS market (> 90% and stable market share; high barriers to entry; ...)
- Microsoft tied its web browser Internet Explorer to the Windows PC OS
- Strategic importance of web browsers
 - Web browsers are entry points for internet search
 - Web browsers are a gateway to web based applications
 - Web based applications could lower applications barrier to entry



Assessment of tying under Article 102

- Case law, e.g. Hilti, Tetra Pak II, Microsoft I
- Two separate products:
 - PC OS (system software)
 - Web browsers (application software)
- Dominance in tying product (PC OS)
- No choice for customers as regards the tied product due to "technical bundling" : coercion of customers to take it (not possible to uninstall)
- Harm to competition: market-foreclosing effect
- No objective justification/efficiencies



Potential Foreclosure of Competition

- Tying gives Internet Explorer unparalleled distribution advantage
- This creates disincentives for OEMs and consumers
- Competition on the merits prevented
 - Microsoft's competitors are a priori at a disadvantage even if their products are inherently better
- Downloading cannot offset the effect of tying
 - Consumer and enterprise surveys; information deficit and status quo bias



Potential Foreclosure of Competition

- Indirect network effects
 - Artificially induces content providers and software developers to code for Internet Explorer
- Tying has a detrimental impact on innovation
 - Internet Explorer smallest common denominator as regards web content
 - Slows down circles of innovation (which normally are a consequence of unfettered competition on the merits)



Commitments offered by Microsoft to solve Commission concerns

- OEMs
 - OEMs will be free to pre-install any web browser(s) of their choice
 - Possibility to de-install/turn off Internet Explorer
 - No retaliation from Microsoft
- Must inform remedy for users
 - Choice Screen; distributed via Windows Update also to installed base (Windows XP, Vista and 7)



Choice screen

The screenshot shows a Windows Internet Explorer window titled "Information Regarding Web Browsers - Windows Internet Explorer". The address bar displays "http://www.browserchoice.eu/". The main content area features the heading "Select your web browser(s)" and a grid of five browser options:

Google Chrome	OPERA software	Firefox 3	Windows Internet Explorer 8	Safari 4 Free download For Mac + PC
Google Chrome: a new web browser for Windows.	Opera browser 10 is Internet browser innovation.	Can a browser really make the Web better? Try Mozilla Firefox and see for yourself.	The world's most popular browser – designed by Microsoft for Windows	Introducing Apple Safari 4.0. See the web in a whole new way.
Install	Install	Install	Install	Install
Tell me more	Tell me more	Tell me more	Tell me more	Tell me more

Below the grid is a "Select Later" button and a link for "Further information, Terms of Use and Privacy statement."



Conclusions

- Key technology market
- Swift resolution
- Potential immediate impact on competition
- More consumer choice and innovation



The Intel case

Problematic rebate and discount policy



Context

- Key segment of the high-tech sector
- Pricing-based abuse
 - Case-law
 - Enforcement priorities / impact on competition
- “Naked” abuse
- Remedies and deterrence
- Global backdrop



The Intel Decision

- Conditional rebates and payments to four major OEMs and one PC retailer
- Specific payments to prevent/delay rival products
- Cease and desist order
- Euro 1.06 billion fine



Background

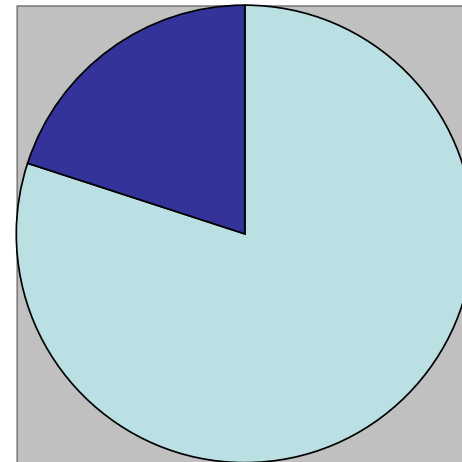
- Product concerned
 - Central Processing Unit of x86 architecture
- Relevant market
 - x86 CPU for desktops, laptops and servers
 - Worldwide





Intel's dominance

- Market features
 - high barriers to expansion and entry
 - CPUs incorporated into computers by OEMs
 - strategic importance of main OEMs
- Market shares



□ INTEL ~ 80%
■ AMD ~ 20%



AMD's growing threat

- AMD improved its products in 2001/2002
 - contemporaneous evidence in the file
- Recognized by both OEMs and Intel
- Intel responded by targeting key suppliers
- Intel submission to the Commission:
 - *“AMD improved its product offerings dramatically with the introduction of its successful Opteron processor”*



Email from Intel executive

“There is so much ingrained 'bad habits' and inertia that has developed over the past decade (which has been hidden/tolerated because we've had a money printing machine with really no competition until recently)”



Conditional rebates

- DELL: conditional on it purchasing exclusively Intel CPUs (12/02-12/05)
- HP: conditional on it purchasing at least 95% of its business desktop CPUs from Intel (11/02-05/05)
- NEC: conditional on it purchasing at least 80% of its CPUs from Intel (10/02-11/05)
- LENOVO: conditional on it purchasing its notebook CPUs exclusively from Intel (01/07-12/07)
- MSH: payments conditioned on exclusive sales of PCs based on Intel CPUs (10/02-12/07)



Proof of conditionality

- Extensive file
 - 141 companies questioned / 21 company sites inspected
 - file is several hundred thousand pages
- Findings based on broad range of evidence
 - contemporaneous e-mails
 - corporate statements
- Evidence Intel sought to conceal the conditions associated with its payments



Specific example

- HP wanted to switch towards AMD
- Intel makes rebate payment conditional on 95 % requirement
- AMD offers HP 1 million CPUs for free
- HP only takes 160 000 of the free CPUs to stay within the Intel limit
- HP confirms that the reason was the market share limit



Framework of analysis

- Case-law is important
 - Legal certainty
- Consistent with enforcement priorities : analyzing effects on competition
 - Need to ground cases in a real-world analysis
 - As efficient competitor test can be a good way of measuring effects



Legal and economic analysis

- Conditional rebates/payments fulfill the conditions of the Hoffmann-La Roche case-law (loyalty rebates)
- Coherent story in the market
 - Intel recognized AMD's growing threat
 - targeted OEMs to contain AMD
 - Importance of key OEMS
- As efficient competitor test
 - hypothetical exercise
 - Capability of the rebates to foreclose an equally efficient competitor
- No objective justification



What kind of rebates are OK?

- Genuine volume-based rebates
 - Linked to volume of purchases and fixed objectively
 - Applicable/applied in a uniform way to all possible purchasers
 - Reflect scale for larger purchasers
 - Incentivize more sales based on merit
 - Allow for competition on the merits from rivals
- But not de facto conditional rebates “dressed up” as volume rebates
 - Michelin I



LOYALTY REBATES (conditional rebates)

- Rebate given to purchasers who obtain all or most of their requirements from supplier
- WHY ABUSIVE ?
Price → not based on transaction BUT on whether, or to what extent, he buys elsewhere
- HOW TO DISTINGUISH FROM QUANTITY REBATES ?
 - Hofmann-Laroche: terms of sales are crucial
 - Intel: coherent story (Intel recognised AMD's growing threat; targeted OEMS to contain AMD; no objective justification)
- FORMS OF LOYALTY REBATES
 - fixed ('all requirements') SUIKER UNIE
 - variable HOFMANN - LA ROCHE



TARGET REBATES

- Not quantity discounts
- Not loyalty rebates of the type at issue in Intel / Hoffmann (do not depend on the customer achieving all or most of his requirements from the supplier)



- **rebate given if customer has reached an individually specified sales target**
- **sales target normally based on customer's purchases during a reference period (e.g. previous year)**
- **if target exceeded (or reached), the discount is granted**
- **discount for the entire period only if target is reached**

● MICHELIN

COCA-COLA

IRISH SUGAR

VIRGIN/BA



Naked restrictions

- Three OEMs:
 - Payments – unrelated to any particular purchases from Intel – on condition that computer manufacturer postpones or cancels launch of specific AMD-based products
 - Payments imposing distribution restrictions of AMD-based products
- Legal analysis based on *Irish Sugar*
- Directly prevents innovative products reaching consumers: effect is to limit consumer choice

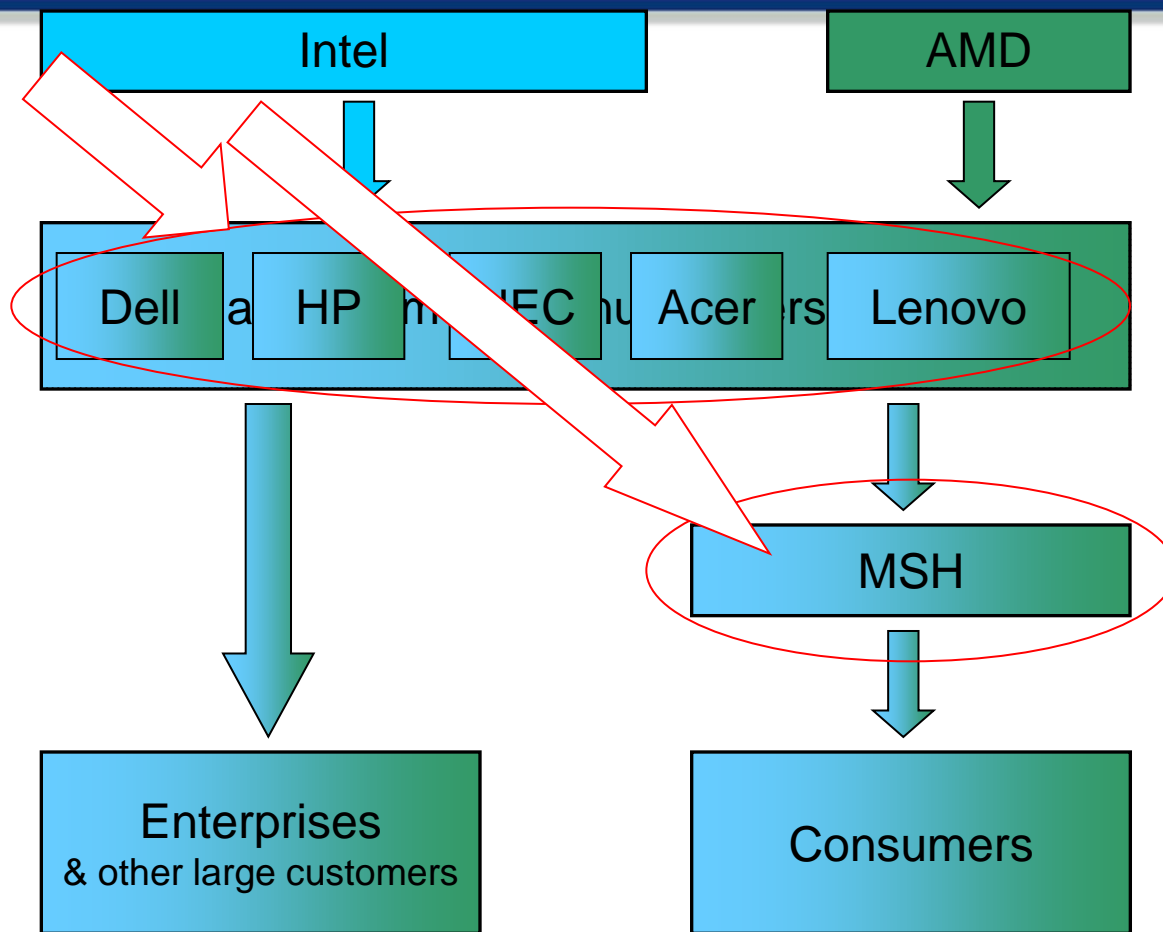


Single strategy

- Individual abuses are a part of a single strategy aimed at foreclosing AMD
- The infringement runs from October 2002 to December 2007
- Consumers are harmed due to limited choice and impact on innovation
 - Strong support from several consumer organisations



Competition





The fine

- Perspective is important
- Case-law is consistent and clear
- Intel tried to hide its conduct
- Starting percentage is 5%
- Sales calculation is conservative
- Less than 5% of annual turnover



The global context

- JFTC (2005)
- KFTC (2008)
- EU (2009)
- New York Attorney General (opened in 2009)
- US FTC (settled in 2010)



Conclusions

- Great importance of x86 CPU market
 - Market generated revenues of \$30 billion in 2007
- Intel engaged in a series of anticompetitive practices aimed at foreclosing AMD - its only competitor
- Rebates not a problem - the conditions were
- Case-law and effects-based analysis
 - Consumers' choice limited
 - Innovation harmed