Abusive behaviour by dominant companies

The Intel and Microsoft cases

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*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”?

Jak se máš?

I don’t understand.
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

• Penalty Payment Decision of 27 February 2008
  – Reasonable Pricing of the Interoperability Information
EU fines Software Giant 899 million Euros

Do you promise to share information with your rivals?

I've already had a sit-down with them...

Fine

Microsoft
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

Select your web browser(s)


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

Tell me more

Select Later

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
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
Original Equipment Manufacturers (« OEMs »)

- Intel
- AMD
- Dell
- HP
- NEC
- Acer
- Lenovo

Enterprises & other large customers

Consumers

MSH
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