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# **AN ANTITRUST ANALYSIS OF THE FEDERAL TRADE COMMISSION'S COMPLAINT AGAINST INTEL**

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COMMISSION'S COMPLAINT AGAINST INTEL**

**By**

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# AN ANTITRUST ANALYSIS OF THE FEDERAL TRADE COMMISSION'S COMPLAINT AGAINST INTEL

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*The Federal Trade Commission's recent complaint targets the Intel Corporation for antitrust scrutiny under Section 5 of the Federal Trade Commission Act and Section 2 of the Sherman Act. The Commission alleges that, through the use of loyalty discounts offered to microprocessor purchasers, Intel unlawfully excluded rivals and harmed consumers in the microprocessor and graphics processor markets. This article analyzes the Commission's claims. The Commission's reliance on Section 5 should be viewed with suspicion because it allows the Commission to evade the more stringent standards of proof that have been emerged in the Supreme Court's Section 2 jurisprudence. Furthermore, the Commission's actions surrounding its prosecution of Intel reflect an adversarial attitude that undermines the Commission's stated comparative advantages over private litigants. Moreover, the Commission's allegations form a weak case when evaluated under the conventional Section 2 standard. Unlike many Section 2 cases alleging speculative future consumer harm, the disputed conduct in this case has been in the marketplace for nearly a decade, and its competitive footprint is readily observable. The available data do not support the Commission's theory that Intel's behavior harmed consumers. To the contrary, it is almost certain that Intel's distribution contracts led to tangible, demonstrable consumer welfare gains in the form of lower prices. Accordingly, the Commission's complaint against Intel threatens to harm consumers directly in the computer industry as well as indirectly by undermining the stability and certainly which longstanding Section 2 jurisprudence has afforded the business community by requiring the plaintiffs offer rigorous proof of competitive harm.*

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\* Associate Professor, George Mason University School of Law and Department of Economics; Director of Research, International Center for Law and Economics. I am grateful to Bruce Kobayashi, Geoffrey Manne, and Judd Stone for helpful comments. The International Center of Law and Economics provided financial support for which I am also grateful. The views expressed herein are my own and do not necessarily represent the views of the International Center for Law and Economics, its affiliates or supporters.

## Introduction

On December 16, 2009, the Federal Trade Commission filed a complaint against the Intel Corporation ("Intel") alleging that its practices of issuing loyalty discounts and in the microprocessor and graphic processor markets violated the antitrust laws. This complaint is noteworthy for at least five reasons. First, prior to the complaint, the European Union had already assessed record-setting antitrust fines against Intel for the same conduct. Second, Intel had also already effectively ended the dispute when it settled with its chief rival, AMD. The settlement included provisions that would constrain Intel's ability to enter into certain distribution contracts. Third, the FTC complaint not only alleges a violation of Section 2 of the Sherman Act ("Section 2"), but also Section 5 of the Federal Trade Commission Act ("Section 5"). Fourth, unlike many other antitrust cases – which often require courts or enforcement agencies to speculate as to the long-run future effects of alleged anticompetitive conduct, the discounts at issue were employed by Intel for years, obviating reliance on mere conjecture and enabling empirical testing of any alleged anticompetitive effects. Finally, the Commission's deviation from its standard procedural practices in favor of a "sue first, facts later" approach undermines the Commission's claims that its inherent expertise and its neutrality justify its role as administrative enforcer of the FTC Act.

The Commission's anticompetitive theory is that Intel's loyalty discounts provide original equipment manufacturers ("OEMs") with an incentive to purchase almost all of their microprocessor and graphics processor units ("CPUs", "GPUs") from Intel. Accordingly, Intel's rivals lose sales, and are unable to achieve minimum efficient scale to compete effectively with Intel. After these rivals – chief among them AMD – are excluded, Intel is free to raise prices to recoup profits lost by the original discounts. In this framework, these discounts act as de facto "exclusive dealing" arrangements, excluding 'locked-in' OEMs from purchasing their requirements from AMD or other CPU/GPU manufacturers.

As a Section 2 theory, the allegation described above is neither a particularly novel nor a particularly damning one. Antitrust analysis, however, is a fact-intensive endeavor. As a Section 2 claim, the proffered theory is relatively weak and unpersuasive on the facts. A line of Supreme Court Section 2 cases enjoying supermajority (and often unanimous) support establishes that Section 2 plaintiffs must demonstrate consumer harm, a showing available data suggests is unlikely to be forthcoming. Weighing the manifest benefits to consumers from lower prices against the speculative costs of future harm to competition counsels strongly against the Commission's case, and, as a matter of Section 2 law, the Commission is likely to fail.

While a rather conventional Section 2 pleading, the Commission's Section 5 allegations in this context are both novel and troubling. The Commission's attempt to extend Section 5 to a situation for which the Supreme Court has expounded clear, deliberate, and sensible jurisprudence is not only unpersuasive, but flagrant. Section 5 has

conventionally and wisely been limited to situations such as invitations to collude, where more traditional sources of antitrust law do not extend. Instead, the Commission is rather openly attempting to use Section 5 to dilute the current antitrust law itself in order to advance its own alternative, interventionist conception of antitrust policy.

This paper analyzes the Commission's complaint and demonstrates that the Commission is highly unlikely to prevail on its claim under Section 2. It discusses the Commission's theory of anticompetitive harm, and demonstrates why a finding of actual consumer harm, necessary for Section 2 liability, is improbable. This paper then further explains why the requirement that plaintiffs demonstrate actual consumer harm is a bulwark for protecting consumer welfare from the chilling effects of the imposition of antitrust liability against pro-competitive conduct. It concludes by addressing the Commission's justifications for its new and expansive proposed use of Section 5, and discusses the significant consumer welfare losses that would result from the injection of such uncertainty into the marketplace.

## **Antitrust Analysis of Intel's Loyalty Discounts**

In recent years, Intel has faced tremendous scrutiny, including investigations or legal proceedings initiated by the Federal Trade Commission, its chief rival AMD, and international antitrust enforcement agencies. The focus of the antitrust scrutiny aimed at Intel has been the use of "loyalty discounts" offered to OEMs to carry its products.<sup>1</sup> Antitrust authorities abroad, and now the Federal Trade Commission and the New York State Attorney General, have argued that these discount distribution contracts operate like exclusive dealing contracts, depriving rivals of the opportunity to compete for scale. The most recent complaint against Intel also alleges that Intel's loyalty discounts constitute "unfair methods of competition" within the meaning of Section 5 of the Federal Trade Commission Act.<sup>2</sup>

Under Section 2 of the Sherman Act, the Supreme Court's monopolization jurisprudence – faithful to the Chicago and Harvard-based error-cost framework that has animated

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<sup>1</sup> The term loyalty discount is often used in different ways both in the literature and in practice. Loyalty discounts, as used here, refer to a form of non-linear pricing in which the unit price of a good falls when the buyer meets a buyer-specific threshold requirement. See Bruce H. Kobayashi, *The Economics of Loyalty Discounts and Antitrust Law in the United States*, 1 COMP. POL'Y INT'L 115 (2005). The buyer-specific threshold distinguishes loyalty discounts from traditional volume discounts. Loyalty discounts are often associated with both all-units discounts and market-share discounts. When the buyer meets its specified threshold, an all-units discount requires that the seller give a per unit rebate to the buyer applied to all units. A market-share discount occurs if the buyer specific threshold involves a commitment from the buyer to allocate particular share of the buyer's total purchases to the seller. Another is the use of buyer specific thresholds that require a buyer to allocate a significant share of his total purchases to a single seller in order to obtain the discount or rebate. Thus, one can consider both all-units discounts and market-share discounts as a subset of loyalty discounts. *Id.* The Commission's Complaint includes allegations that both Intel's traditional volume discounts and use of loyalty discounts violated the antitrust laws. For simplicity, we will use the term loyalty discount throughout the paper to refer to the discount contracts at issue in the Complaint.

<sup>2</sup> 15 U.S.C. § 45(a)(1).

modern monopolization law – requires a *rigorous demonstration of actual or highly likely* consumer harm to support a finding of liability for exclusionary conduct. Mere speculation of possible future competitive harm or fanciful counterfactuals under which consumers would have received greater benefits are not enough to shift the risk of antitrust error to consumers.<sup>3</sup> Courts sometimes analyze loyalty discounts as *de facto* exclusive dealing contracts,<sup>4</sup> and sometimes apply predatory pricing-based price-cost standards. Whichever legal standard is ultimately applied to analyze loyalty discounts, under *any* test, the plaintiff bears the burden of demonstrating that the contracts harmed rivals, increased their costs, and harmed competition in the form of higher prices, reduced output, or less innovation. In the case of loyalty discounts, the thrust of the anticompetitive theory is that the contracts, like with full or partial exclusive dealing contracts, deprive rivals of the opportunity to compete for distribution sufficient to achieve minimum efficient scale.<sup>5</sup> In the limiting case where the threshold to receive the discount is set to 100 percent of the buyer's purchases, the practices are analytically related in the sense that the seller is compensating the buyer for exclusivity. There are, of course, valid and distinct pro-competitive and anticompetitive theories of loyalty discounts and exclusive dealing contracts.<sup>6</sup> The pro-competitive benefits to consumers generated by Intel's loyalty discounts are tangible, intuitive, and apparent: Intel's discounts offer OEMs lower prices which are passed on to consumers in the retail market. When OEMs offer full or partial exclusivity to competing microprocessor manufacturers, the battle between Intel and AMD for access to consumers intensifies, leading to even greater discounts and larger gains for consumers.<sup>7</sup>

Intel's various rebates, the Commission alleges, deprive other chip manufacturers of the opportunity to compete for distribution, thereby deterring entry and expansion by AMD and other manufacturers into the computer and graphical processor markets. Specifically, the Commission alleges that "Intel entered into anticompetitive arrangements that were designed to limit or foreclose [manufacturers'] use of competitors' relevant products."<sup>8</sup> Intel allegedly punished OEMs that purchased from AMD with higher prices, while rewarding OEMs who purchased all or nearly all their requirements from Intel.<sup>9</sup> Intel's loyalty discounts allegedly had the effect of foreclosing competition in the microprocessor market to the detriment of consumers.<sup>10</sup>

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<sup>3</sup> For a discussion at greater length about the perils of the application of complicated antitrust analysis by generalist judges, see Michael R. Baye & Joshua D. Wright, *Is Antitrust Too Complicated For Generalist Judges? The Impact of Economic Complexity & Judicial Training on Appeals*, 54 J. L. & ECON. \_\_\_ (forthcoming 2011), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1319888](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1319888).

<sup>4</sup> ANTITRUST LAW DEVELOPMENTS 252-254 (6th ed. 2007).

<sup>5</sup> Benjamin Klein & Kevin M. Murphy, *Exclusive Dealing Intensifies Competition for Distribution*, 75 ANTITRUST L.J. 433 (2008).

<sup>6</sup> Alden A. Abbott & Joshua D. Wright, *Antitrust Analysis of Exclusive Dealing and Tying Arrangements*, in ANTITRUST LAW AND ECONOMICS (Edward Elgar Publishing, 2009); Klein & Murphy, *supra* note 5.

<sup>7</sup> Klein & Murphy, *supra* note 5; Joshua D. Wright, *Antitrust Law and Competition for Distribution*, 23 Y. J. ON REG. 169 (2006).

<sup>8</sup> *In re Intel Corp.*, No. 9341 ¶ 6 (Fed. Trade Comm'n, Dec. 16, 2009).

<sup>9</sup> *Id.*

<sup>10</sup> *Id.* at ¶ 7.

Collectively, the alleged impact of Intel's competitive efforts and incentives offered to OEMs to distribute Intel products was to "stall the widespread adoption of non-Intel products."<sup>11</sup>

## The Error-Cost Framework and Loyalty Discounts

As discussed, the primary anticompetitive concerns with loyalty discounts are, from an economic perspective, analytically similar to the potential harms associated with exclusive dealing contracts. As is the case with exclusive dealing contracts, the potential anticompetitive concern articulated by economists,<sup>12</sup> and echoed by the Commission in its complaint, is that a monopolist might utilize loyalty discounts to fortify its market position, raise rivals' costs of distribution by depriving the opportunity to achieve efficient scale, and ultimately harm consumers by putting competitors out of business.

At a recent set of hearings on antitrust analysis of exclusive dealing contracts, a sensible consensus view emerged that a necessary condition for anticompetitive harm is that the contract *actually deprives rivals of the opportunity to compete*.<sup>13</sup> Even then, of course, countervailing competitive benefits need to be assessed. Like other vertical contractual arrangements between manufacturers and distributors, the economic literature is replete with pro-competitive justifications for exclusive dealing and empirical evidence suggesting that vertical contractual arrangements are generally pro-competitive.<sup>14</sup> Assessing the appropriate application of these anticompetitive theories in any particular setting is enormously difficult, and given the empirical consensus that vertical contractual arrangements are generally pro-competitive, any such assessment must take into account the costs imposed upon consumers by erroneous antitrust intervention.

In his seminal article, Judge Frank Easterbrook was the first to develop an evidence-based framework for resolving competitively-ambiguous practices through the design of optimal legal standards informed by existing theory and evidence, and through the

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<sup>11</sup> *Id.* at ¶ 11. The Commission also alleged a similar course of conduct in the GPU market. See generally *id.* at ¶ 17-19.

<sup>12</sup> For a discussion of these models, see Bruce H. Kobayashi, *The Economics of Loyalty Discount and Antitrust Law in the United States*, 1 COMP. POL'Y INT'L 115 (2005).

<sup>13</sup> U.S. DEPT. OF JUSTICE, COMPETITION AND MONOPOLY: SINGLE FIRM CONDUCT UNDER SECTION 2 OF THE SHERMAN ACT 137 (2008), available at <http://www.usdoj.gov/atr/public/reports/236681.pdf> (internal citations omitted).

<sup>14</sup> See Klein & Murphy, *supra* note 5; Abbott & Wright, *supra* note 6; Daniel P. O'Brien, *The Antitrust Treatment of Vertical Restraints: Beyond the Possibility Theorems*, in REPORT: THE PROS AND CONS OF VERTICAL RESTRAINTS 40, 80 Konkurrensverket (Swedish Competition Authority, 2008), available at [http://www.konkurrensverket.se/upload/Filer/Trycksaker/Rapporter/Pros&Cons/rap\\_pros\\_and\\_cons\\_vertical\\_restraints.pdf](http://www.konkurrensverket.se/upload/Filer/Trycksaker/Rapporter/Pros&Cons/rap_pros_and_cons_vertical_restraints.pdf); James C. Cooper, Luke M. Froeb, Dan O'Brien & Michael G. Vita, *Vertical Antitrust Policy as a Problem of Inference*, 23 INT'L J. INDUS. ORG. 639 (2005); Francine Lafontaine & Margaret Slade, *Empirical Assessment of Exclusive Contracts*, in HANDBOOK OF ANTITRUST ECONOMICS (Paolo Buccirossi ed., MIT Press 2008).

allocations of burdens.<sup>15</sup> Judge Easterbrook's "error-cost framework" rests on three premises. First, it is very difficult to determine whether challenged conduct is pro-competitive, anticompetitive, or completely neutral.<sup>16</sup> Second, this difficulty raises the incidence of two kinds of errors: false positives (Type I errors), where otherwise legitimate conduct is condemned to antitrust sanctions, and false negatives (Type II errors), where otherwise exclusionary conduct is permitted under the antitrust laws.<sup>17</sup> Finally, the former generally create greater social costs because market forces offer at least some correction as against Type II errors but none with regard to Type I errors.<sup>18</sup>

It should be noted, of course, that the Chicago School does not enjoy a monopoly over the intellectual foundations of the error-cost framework. Indeed, FTC Commissioner Kovacic has persuasively demonstrated that the Harvard School has played an integral role in promoting the administrability of antitrust rules, which is a predecessor of the error-cost framework.<sup>19</sup> Perhaps the most well known and oft-cited example of the Harvard School's contribution to the incorporation of error-cost concerns into modern antitrust jurisprudence is Justice (then Judge) Stephen Breyer's observation in *Barry Wright* that the "antitrust laws very rarely reject . . . 'beneficial birds in hand' for the sake of more speculative . . . 'birds in the bush.'"<sup>20</sup>

The error-cost framework counsels that the optimal antitrust regime minimizes the social costs and maximizes the social benefits of antitrust enforcement by crafting and applying rules with reference to the available empirical evidence in the context of a given business practice, subsequently moving from the empirical baseline only through careful Bayesian updating.<sup>21</sup> The threshold inquiry, then, is what legal and economic scholars know about the incidences of pro-competitive and anticompetitive loyalty discounts and exclusive dealing contracts. The answer is that the best available evidence suggests that vertical restraints generally, and loyalty discounts and exclusive dealing contracts specifically, are largely pro-competitive.<sup>22</sup>

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<sup>15</sup> Frank H. Easterbrook, *The Limits of Antitrust*, 63 TEX. L. REV. 1 (1984); see also Geoffrey A. Manne & Joshua D. Wright, *Innovation and the Limits of Antitrust*, 6(1) J. COMP. L. & ECON. 153 (2010).

<sup>16</sup> Easterbrook, *supra* note 15, at 15.

<sup>17</sup> *Id.*

<sup>18</sup> *Id.* at 15-16.

<sup>19</sup> William Kovacic, *The Intellectual DNA of Modern U.S. Competition Law for Dominant Firm Conduct: The Chicago-Harvard Double Helix*, 2007 COLUM. BUS. L. REV. 1 (2007).

<sup>20</sup> *Barry Wright Corp. v. ITT Grinnell Corp.*, 724 F.2d 227, 234 (1st Cir. 1983).

<sup>21</sup> Easterbrook, *supra* note 15, at 23-24.

<sup>22</sup> See generally Cooper et al., *supra* note 14, at 18 (concluding that while "some studies find evidence consistent with both pro- and anticompetitive effects . . . virtually no studies can claim to have identified instances where vertical practices were likely to have harmed competition."); Lafontaine & Slade, *supra* note 14, at 22 ("the evidence thus supports the conclusion that in these markets, manufacturer and consumer interests are apt to be aligned."). In the most recent and comprehensive survey of the literature on vertical contracting practices, O'Brien concludes that "with few exceptions, the literature does not support the view that these practices are used for anticompetitive reasons," and the evidence supports "a fairly strong prior belief that these practices are unlikely to be anticompetitive in most cases." O'Brien, *supra* note 14, at 72-73.

Fundamentally sound decision-making would thus dictate that an antitrust liability rule for exclusive dealing contracts and loyalty discounts require something more than the demonstration of a theoretical possibility of consumer harm. Indeed, the Supreme Court has broadly recognized that error costs are a core concern in elucidating the appropriate scope of Section 2 in a line of cases enjoying supermajority support: *Credit Suisse*,<sup>23</sup> *Brooke Group*,<sup>24</sup> *Trinko*,<sup>25</sup> and, most recently, *Linkline Communications*.<sup>26</sup> The Court's support for the error-cost framework is far from qualified or marginal: across these four cases alone, the Court cumulatively voted 31-4 in favor of majority (and often unanimous) opinions recognizing the core principles of the error-cost framework.<sup>27</sup> Clearly, then, the imposition of a consumer harm requirement to satisfy error-cost principles is not, in the parlance of software developers, a bug, but rather a feature of Section 2 jurisprudence.<sup>28</sup>

However, there is no evident consumer harm arising from Intel's loyalty discounts. In fact, as will be discussed below, there is substantial evidence that Intel's practices have generated significant benefits for consumers. An antitrust policy concerned with maximizing total consumer welfare should not readily condemn tangible consumer benefits on the grounds of theoretically-possible, but unproven, consumer harms. Thus, as previously noted, the Sherman Act sensibly articulates a preference for the tangible "beneficial birds in hand" of present lower prices "for the sake of more speculative . . . birds in the bush."<sup>29</sup> To trade certain consumer benefits today to prevent speculative future harms tomorrow, as Judge Breyer rightly pointed out, would "open[] the door to similar speculative claims that might seek to legitimate even the most settled unlawful practices."<sup>30</sup> Nowhere is the argument for such caution stronger than in cases such as Intel, where the competitive footprint of the business practices at issue is easily discernable because it has survived in the market for a significant period of time.

## **Intel's Share-Based Discounts are a Normal and Legitimate Part of the Competitive Process and There is No Apparent Evidence of Consumer Harm**

Intel's loyalty discounts began in 1999; accordingly, the Commission's economic theory is empirically testable. The Commission's theory has several testable implications

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<sup>23</sup> *Credit Suisse (USA) LLC v. Billing*, 127 S. Ct. 2383 (2007).

<sup>24</sup> *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993).

<sup>25</sup> *Verizon Commc'ns v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398, 408 (2005).

<sup>26</sup> *Pac. Bell. Tel. Co. v. Linkline Commc'ns, Inc.*, 129 S. Ct. 1109, 1113-14 (2009).

<sup>27</sup> For more, see Douglas H. Ginsburg & Leah Brannon, *Antitrust Decisions of the U.S. Supreme Court, 1967 to 2007*, COMP. POL'Y INT'L 3 (2007).

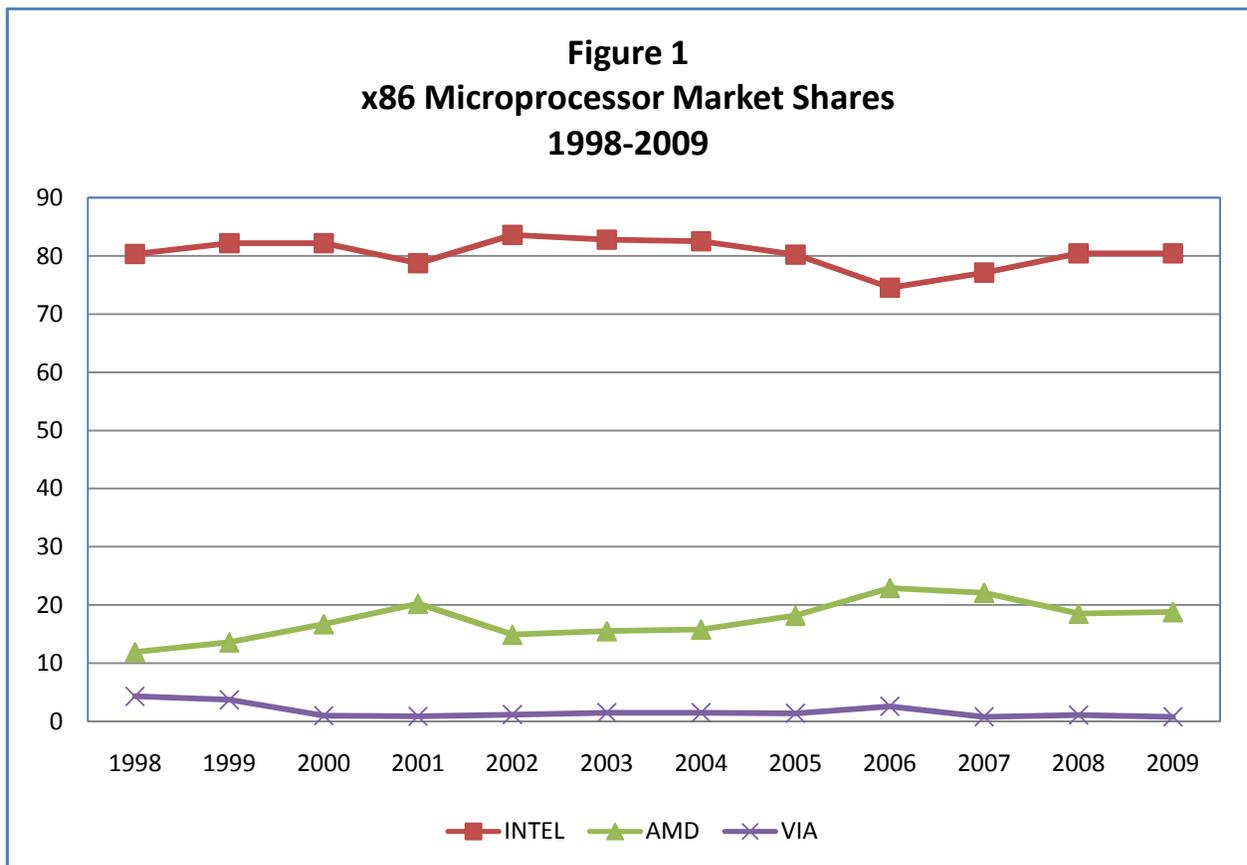
<sup>28</sup> For more on this point, see posting of Joshua D. Wright to Truth On the Market, <http://www.truthonthemarket.com/2009/12/16/features-v-bugs-intel-and-the-relationship-between-sections-2-and-5/> (Dec. 16, 2009, 13:52 EST).

<sup>29</sup> *Barry Wright Corp. v. ITT Grinnell Corp.*, 724 F.2d 227, 234 (3d. Cir. 1983).

<sup>30</sup> *Id.*

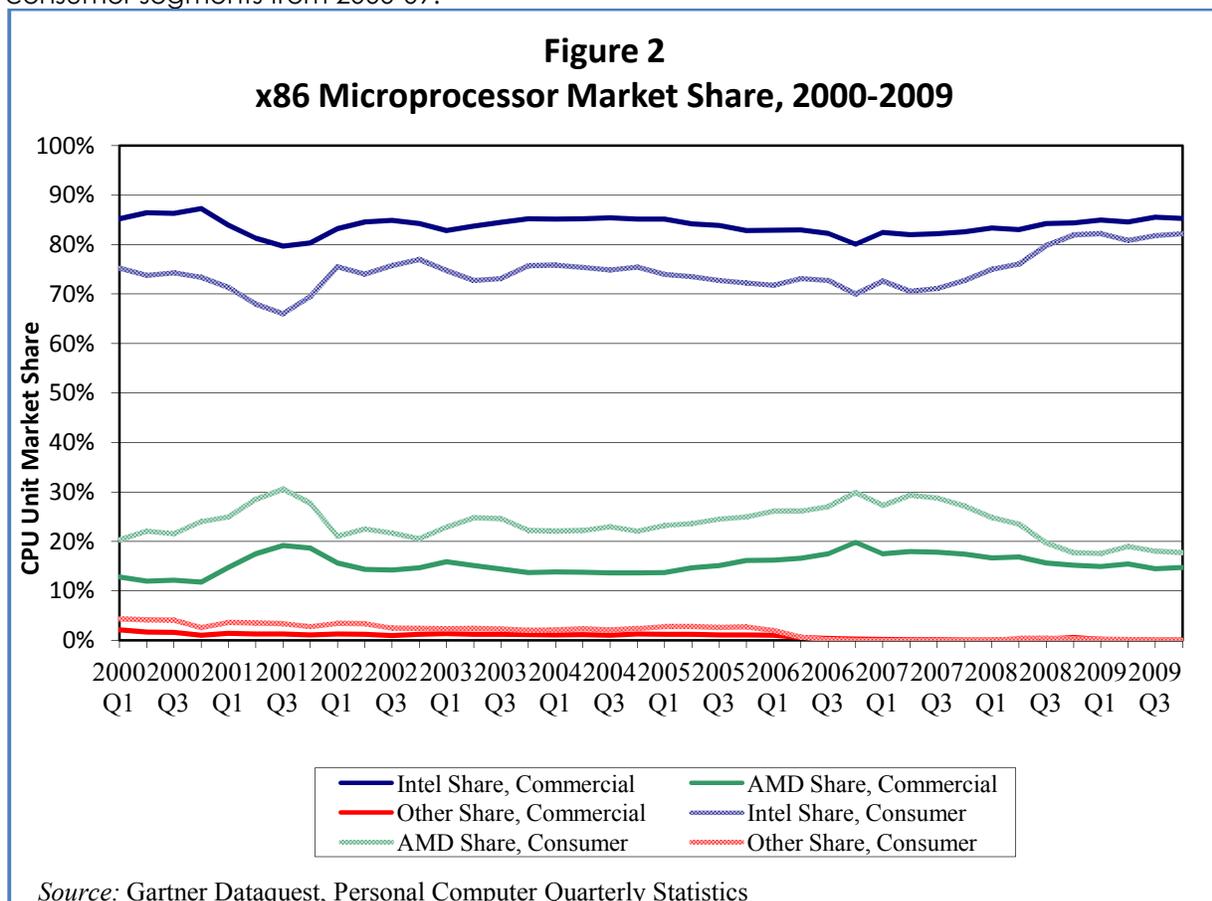
involving both the relevant product and financial markets. The most obvious implication of the Commission's theory is that one would expect Intel's market share to have increased and AMD's market share to have decreased since 1999. We would further expect both companies' share prices to increase and decrease respectively after Intel engaged in the complained-of contracts. Similarly, the theory predicts that AMD would not be likely to make substantial investments in future capacity because those investments could not be recouped once AMD was excluded from the marketplace. The empirical data from the product and financial markets bear out none of these implications, however, and therefore undermines the Commission's theory of liability.

The first prediction that arises out of the Commission's theory of harm is that Intel's loyalty discounts with OEMs would reduce AMD's share in the x86 microprocessor market. Figure 1 includes AMD, Intel, and VIA market shares from 1998-2009 and reveals no obvious reduction in AMD's share after Intel commenced the conduct that triggered AMD's complaint.<sup>31</sup>



<sup>31</sup> The source data for Figure 1 is from Mercury Research.

Figure 2 presents the market share data for Intel, AMD and all others by commercial and consumer segments from 2000-09.



At some level of certainty, it is impossible to disprove the Commission's theory of harm with any empirical evidence. For example, one could always hypothesize a counterfactual world in which AMD's share would have been higher but for Intel's discount contracts. Or one could argue that AMD has been able to finance overall growth even in the face of enormous competitive obstacles, but that it is unsustainable. However, the burden does not lie with Intel to disprove the Commission's theory of speculative harm or provide evidence that microprocessor prices are lower than they would have been under all other possible counterfactual scenarios. Traditional antitrust principles sensibly require exactly the opposite by burdening the plaintiff with an obligation to proffer convincing evidence of actual consumer harm. The market share data in Figures 1 and 2 plainly do not support an inference that Intel's conduct raises significant competitive concerns. Further, AMD's market share is higher in 2006 than when the conduct appeared to become a competitive issue in 1999. The only significant dip in AMD's share appears to be after 2002 when AMD appeared to

experience some technical problems which were resolved in 2003 with the launch of the 64-bit Opteron chip.<sup>32</sup>

A second prediction arising out of the Commission's theory of harm is that AMD's margins, sales, revenue and profits would fall as its scale decreased and costs increased. The available data are not consistent with the Commission's theory. While data are not available for the entire time period, Table 1 depicts AMD's gross margins on microprocessors from 2004-2009.<sup>33</sup> Contrary to the predictions of the theory, AMD's profit margins on microprocessor sales do not fall dramatically during these years. There is no evidence that Intel's distribution contracts raised AMD's costs much less had an impact on AMD's ability to compete.

Figure 3 uses alternative measures – microprocessor sales revenue and operating income by segment --- to evaluate the impact of Intel's distribution practices on its chief rival.<sup>34</sup> Again, the data offer no comfort to the Commission's theory. Indeed, the sales revenue data demonstrate that, contrary to claims that AMD was being deprived of scale during the relevant time period, AMD actually enjoyed a significant expansion of output. While it is difficult to precisely identify AMD's minimum efficient scale, there is little doubt that AMD's scale was increasing, and not decreasing during the relevant time period as it would be if Intel's distribution contracts were depriving AMD of the opportunity to compete on even footing for distribution.

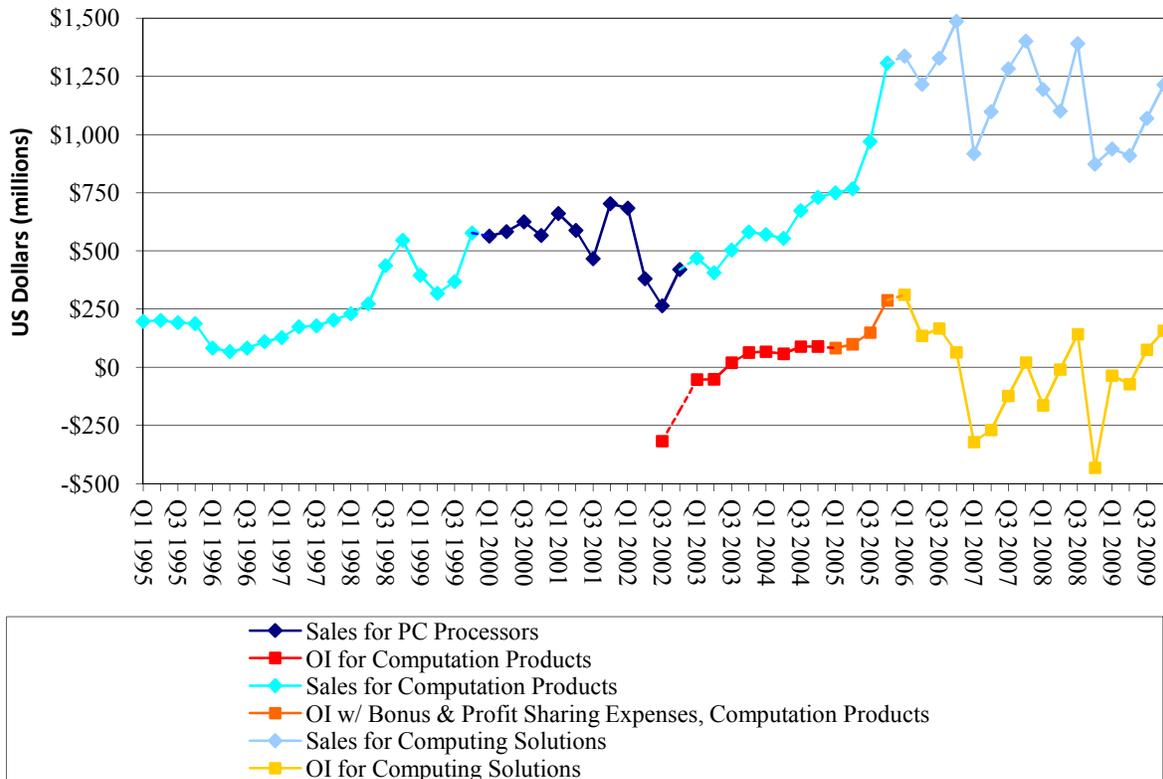
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<sup>32</sup> *A Weaker David to Intel's Goliath*, BUSINESS WEEK, Oct. 21, 2002, available at [http://www.businessweek.com/print/magazine/content/02\\_42/b3804048.htm?tc](http://www.businessweek.com/print/magazine/content/02_42/b3804048.htm?tc) (noting that "current chips are too slow for the higher-margin desktops PC makers are now concentrating on to boost profits, which production glitches have delayed its next-generation PC chips").

<sup>33</sup> See *infra* Table 1.

<sup>34</sup> For 1996 - Q4 1999, Computation Products (CP) sales includes microprocessor, core logic and embedded processor sales. In 1995, AMD reported corporate wide sales only; the figures here are estimated based on an annual 1995 CP % published in AMD's 1996 10K. 1995 data also includes NexGen, which AMD acquired in January 2006. For Q1 2000 - Q4 2002, PC Processor Group (PC) includes all AMD microprocessor sales. In Q3 2003, AMD regrouped chipsets and microprocessors together as CP and back reported its financial statements. Thus for Q1 2003 - Q4 2005, CP sales data are presented. In Q1 2007, AMD acquired ATI's embedded products business. The newly formed Computing Solutions includes CP and new embedded products. AMD does not report any microprocessor specific operating income (OI) until Q1 2003. Q1 2005 - Q4 2005 CP OI includes allocated bonus and profit sharing expenses. When subsequent statements present conflicting sales numbers due to organizational changes or restated results, the most recent number is used.

**Figure 3**  
**AMD Microprocessor Quarterly Sales and Operating**  
**Income, 1995 - Q4 2009**



Sources: AMD Quarterly Sales and Profits, Q1 1996 - Q4 2009.

Overall, AMD's financial performance is highly variable over the relevant time period. While a comprehensive analysis of AMD's financial performance would include explaining the various dips in AMD's performance, such an effort is beyond the scope of this analysis relying only on publicly available data.<sup>35</sup> However, the trend in AMD's financial performance during the time period in which Intel's discounts were allegedly harming AMD and microprocessor consumers is, contrary to the theory's predictions, a healthy upward trend. Again, the data offer no support for the Commission's anticompetitive theory and are consistent with vigorous competition in the microprocessor industry.

<sup>35</sup> For example, AMD apparently experienced a shortage of its Athlon 64 processor during an otherwise successful launch in Fall 2003. See *Athlon 61 CPUs: In Short Supply?*, PC WORLD, Sept. 24, 2003, at 1, available at <http://yahoo.pcworld.com/yahoo/article/0,aid,112631,00,asp>.

Figure 4 offers a different look at AMD's financial performance, relying on the financial markets to generate evidence of the effect of Intel's loyalty discount contracts on AMD.



A visual inspection of Figure 4 reveals that AMD appears to have experienced significant gains in the financial markets from 2001-2002 to 2006, a lengthy period of time during which Intel was actively engaged in the conduct forming the basis of the Commission's complaint. If Intel's distribution contracts with OEMs were likely to produce competitive harm by depriving AMD of scale, thereby allowing Intel to increase market power, one would expect to see a dramatic decline in AMD's share price coupled with an increase in Intel's reflecting the gains from its newfound pricing power. Figure 4 offers no support for the Commission's theory, but is consistent with the pro-competitive interpretation that factors unrelated to Intel's distribution practices are the primary determinants of the relative financial performance of both firms.

Note the decline in AMD's more recent financial performance after 2006. One might be tempted to argue that this recent decline is attributable to Intel's contracts. However, such an inference would require a strained interpretation of the available evidence. The anticompetitive theory predicts that Intel's contracts deprived AMD of profitable access to the market since at least 1999 and predict a steady decline in AMD's performance. However, there is little evidence that AMD was deprived of

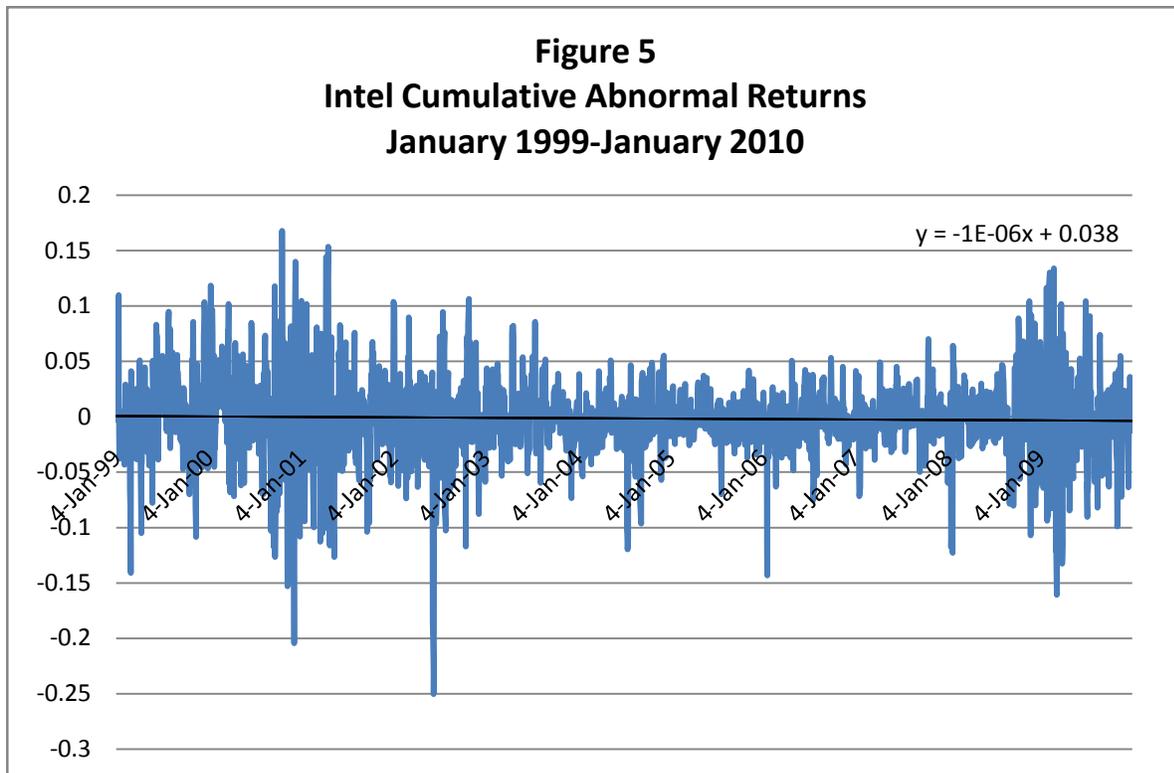
profitable access to the market during the substantial majority of this time period. The mere fact that AMD experienced some expected variation in financial performance cannot be presumptively attributed to Intel without persuasive evidence. Indeed, alternative explanations for AMD's financial performance in recent years are much more plausible. For example, AMD's marketplace troubles in 2007 included botched releases of its Barcelona and ATI products and a design flaw in the Barcelona "quad-core" product which impacted both delivery timing and performance.<sup>36</sup>

The share price data in Figure 4, while probative, do not control for general trends in the market applying to both firms and thus leave open the possibility that despite the fall in Intel's share price, it was earning significant monopoly rents. Figure 5 accounts for this possibility by calculating cumulative abnormal returns earned by Intel during the post-1999 period over which the Commission's complaint alleges Intel engaged in anticompetitive conduct.<sup>37</sup> While a full event study analysis explaining the variation in Intel and AMD abnormal returns over this time period is beyond the scope of this article, evaluating cumulative abnormal returns provides further evidence concerning the competitive consequences of Intel's loyalty discounts. If the Commission's theory is correct, Intel would accumulate significant abnormal returns over the decade long era of anticompetitive conduct. As Figure 5 demonstrates, this has simply not been the case. Intel's cumulative abnormal returns even trend slightly downward over the relevant time period. Further, even during the post-2006 time period in which AMD's share price has fallen more dramatically, there is no observable upward trend in Intel's abnormal returns. These data cast significant doubt over the Commission's prediction that Intel's conduct generated monopoly rents over this decade long period.

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<sup>36</sup> *AMD Hit By Losses Across All Divisions*, MSN MONEYCENTRAL, Dec. 12, 2007, available at <http://news.moneycentral.msn.com/provider/providerarticle.aspx?feed=FT&date=20071213&id=7941190>. Importantly, AMD experienced these losses during a time period when it was able to gain Toshiba as a customer and expand distribution.

<sup>37</sup> Cumulative abnormal returns are calculated with a market model, based on the 1010 trading days between January 3, 1995 and December 31, 1998, prior to the year in which the Commission alleges anticompetitive conduct began. The abnormal return on any given day is the residual of Intel's actual return less the predicted return of the market model.



It is important to distinguish between two alternative propositions about the link between Intel's conduct and AMD's financial performance. The first is that Intel's loyalty discounts have shifted sales away from AMD toward Intel, reducing AMD's sales or revenues, but improving consumer welfare. The second is that Intel's loyalty discounts prevented AMD from competing for access to distribution, deprived AMD from achieving minimum efficient scale, and increased Intel's monopoly power. Only the second set of propositions is of antitrust concern. The well known antitrust maxim that harm to competitors is not sufficient to establish harm to competition fits well here. While the evidence presented above is not consistent with the Commission's theory because the theory implies that Intel's loyalty discounts would cause significant harm to AMD, even if it were present, evidence of harm to a competitor is merely a necessary condition and not sufficient to establish an antitrust violation without further proof of harm to competition.

Taken collectively, the data above do not support the second proposition and do little other than to paint a picture of a highly competitive market characterized by vigorous competition for distribution. Moreover, there is another significant piece of evidence that is difficult to reconcile with the second proposition: AMD's substantial investments into research and development and expanded capacity during the relevant time frame. For example, in October 2005, AMD announced the opening of Fab 36 in Dresden, Germany, and expected to invest a total of \$2.5 billion in this facility by

November 2007.<sup>38</sup> It has also been reported that AMD has made substantial investments into converting its existing Fab 30 from the 130-nm process to the 90-nm process.<sup>39</sup> The evidence appears to support the view that AMD is able to sell all of the chips that it is able to produce and AMD's capacity, not Intel's conduct, constrained AMD. If AMD is successfully selling all of the chips it can produce, and capacity constraints unrelated to Intel's conduct are the binding constraint on AMD's production, such evidence would be inconsistent with the Commission's theory. Moreover, if AMD *believed* that Intel's conduct was leading inexorably to AMD's demise it would be unlikely to make such substantial up-front investments with the expectation of future returns.

Of course, perhaps the most important testable implication of the Commission's theory of harm is that consumer welfare will decline as Intel's processor prices increase. While the data above suggest that the Commission's theory should be viewed with great skepticism, the downward trend in processor prices is not only difficult for the Commission to explain without invoking non-verifiable claims that prices would have fallen *even faster* but for Intel's loyalty discounts, but also highlights the error-cost problem that lies at the core of the antitrust analysis of the Commission's complaint. Figure 6 demonstrates convincingly that consumers have indeed been reaping the benefit of vigorous competition in the microprocessor market.<sup>40</sup> Figure 6 presents the microprocessor pricing data collected by the United States Bureau of Labor Statistics ("BLS"), and reflects quality-adjusted prices. The sharp decline in prices is impressive, with prices declining at an average rate of over 40 percent *annually* since 1999, the time period during which the Commission alleges Intel has been engaging in anticompetitive conduct. Indeed, the quality-adjusted price of microprocessors has declined more rapidly than any of the other 1,200 product categories monitored by the BLS. It is obvious these dramatically spiraling prices have generated huge gains to consumers and contradict the Commission's theory. It these same obvious consumer benefits that represent the "bird in the hand" that the Commission is apparently willing to gamble to pursue its speculative theory of harm.

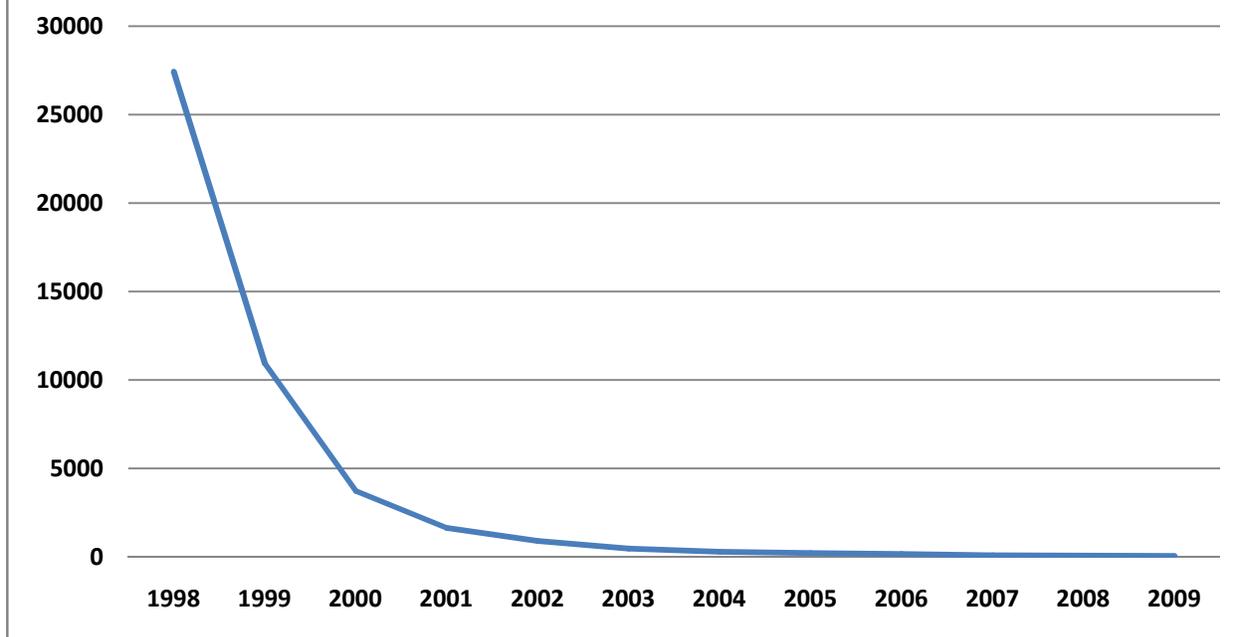
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<sup>38</sup> Press Release, AMD Corp., AMD Opens New 300mm Fab 36 in Dresden, Germany, Continuing its Track Record of Flawless Manufacturing Strategy Execution (Oct. 14, 2005), available at "AMD Opens New 300mm Fab 36 in Dresden, Germany, Continuing its Track Record of Flawless Manufacturing Strategy Execution," [http://www.amd.com/us-en/Corporate/VirtualPressRoom/0,,51\\_104\\_543~101840,0.html](http://www.amd.com/us-en/Corporate/VirtualPressRoom/0,,51_104_543~101840,0.html).

<sup>39</sup> Press Release, AMD Corp., AMD Reports Second Quarter Results (July 14, 2004), available at [http://www.amd.com/us-en/Corporate/AboutAMD/0,,51\\_52\\_1991~87558,00.html](http://www.amd.com/us-en/Corporate/AboutAMD/0,,51_52_1991~87558,00.html).

<sup>40</sup> U.S. Bureau of Labor Statistics producer price index, series identification numbers PCU33441333441312 (Microprocessors), <http://data.bls.gov/cgi-bin/dsrv?pc>, accessed on March 7, 2010.

**Figure 6**  
**BLS Microprocessor Prices**  
**1998-2009**



The portrait of the competitive landscape in the microprocessor market that emerges is difficult to reconcile with the Commission's theory of harm. AMD's performance in the relevant product market and in the financial markets is not consistent with the Commission's theory, Intel's prices have fallen dramatically, and AMD has made significant investments into expanding capacity. Collectively, the data support the view that Intel and AMD have engaged in an intense rivalry that has resulted in substantial benefits for consumers. On the merits, it appears that the most likely outcome of the Commission's prosecution will be to deter further pro-competitive conduct in a dynamic and innovative market at a time when economic growth is of utmost importance to the U.S. recovery from its current financial woes.

### **Intel's Settlement With AMD Does Not Alter the Foregoing Analysis Nor Provide the Commission With a Justification For Its Intel Complaint**

Intel's recent \$1.25 billion settlement with AMD does not change the foregoing analysis. While antitrust authorities and judges must concern themselves with economy-wide error costs in the formation of antitrust policy, Intel's actions must be considered from the perspective of *Intel's* expected costs from an antitrust suit. The foregoing analysis suggests that a U.S. court would and should not be persuaded by speculative claims

about potential future harms in light of compelling evidence that consumers have already reaped the benefits of competition for distribution in the microprocessor market. While Part II argues that the AMD claim would likely be found without merit, and that such a finding would be the correct antitrust outcome, even a small probability of an adverse judgment would result in enormous consequences for Intel. These consequences would include, amongst others, mandatory trebled damages, attorney's fees, and subsequent follow-on actions at the federal and state levels. When weighing the potential of those consequences against the gains from settlement, including the possibility of even greater fines and injunctive relief, a business decision to settle is not an admission of guilt and should not be read as such. Furthermore, the settlement does not excuse the need for rigorous analysis of the Commission's decision to continue its prosecution even *after* the settlement had been reached.

It is unclear what the Commission has to gain by continuing its case against Intel given the combination of EU fines and settled private actions. Intel has already agreed not to engage in the disputed conduct.<sup>41</sup> Thus, even if one assumed *arguendo* that the loyalty rebates harmed consumers, their interests have already been protected by the commitment to cease the disputed conduct. Deterrence also cannot be the answer. In light of the record-setting fines Intel has paid in Europe, as well as fines to international enforcement agencies and to AMD, it is difficult to believe that effective deterrence requires further intervention. Rather, in light of the Commission's attempt to distance itself from the perceived *laissez-faire* approach of its Bush administration predecessors, and the very public effort to dust off Section 5 in a conventional Sherman Act setting, it is difficult to avoid the conclusion that the Commission is attempting to score political points while fighting back against what it perceives to be an unwarranted reduction in the scope of Section 2.<sup>42</sup>

## **Intel's Share-Based Discounts are a Normal and Legitimate Part of the Competitive Process and There is No Apparent Evidence of Consumer Harm**

Section 5 of the Federal Trade Commission Act was enacted in 1914, early in the development of the nation's competition laws.<sup>43</sup> It was intended to address what was

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<sup>41</sup> Press Release, Intel Corp., Settlement Agreement Between Advanced Micro Devices, Inc. and Intel Corporation (Nov. 11, 2009), *available at* [http://download.intel.com/pressroom/legal/AMD\\_settlement\\_agreement.pdf](http://download.intel.com/pressroom/legal/AMD_settlement_agreement.pdf).

<sup>42</sup> Interview by the Wall Street Journal with Jon Leibowitz, Chairman, Fed. Trade Comm'n (January 31, 2010), *available at*

[http://online.wsj.com/article/SB10001424052748704722304575037572444983454.html?mod=WSJ\\_topics\\_obama](http://online.wsj.com/article/SB10001424052748704722304575037572444983454.html?mod=WSJ_topics_obama) ("The courts have pared back plaintiffs' rights in antitrust cases. They're concerned about what they believe to be the toxic combination of class actions, treble damages and a very aggressive plaintiffs' bar. The problem for us as an agency is we come under those restrictions, [too]. So how do we do what we're supposed to do, which is stopping anticompetitive behavior? One tool in our arsenal is using what's known as our Section 5 authority to stop unfair methods of competition.")

<sup>43</sup> 15 U.S.C. § 45 (2006).

at that time perceived to be the risk of “gaps” in U.S. antitrust enforcement under the Sherman Antitrust Act of 1890.<sup>44</sup> In 1938, Congress amended Section 5, adding consumer protection language prohibiting unfair and deceptive trade practices. Since then, the role of Section 5 in antitrust enforcement has been limited to gap-filling or to attack incipient violations of the Sherman Act. The Commission’s prosecution of Intel under Section 5, however, reflects a return to economically-undisciplined antitrust jurisprudence rather than a modest and narrowly-tailored application consistent with the underlying principles of the Sherman Act.

The Commission has offered various defenses of its unprecedented and controversial application of Section 5 against Intel. For example, in the majority statement in support of the Section 5 case against Intel, the Commission offered the defense that dissatisfaction with the Supreme Court’s interpretation of Section 2 warranted expansion of the Commission’s authority:

*Despite the long history of Section 5, until recently the Commission has not pursued free-standing unfair method of competition claims outside of the most well accepted areas, partly because the antitrust laws themselves have in the past proved flexible and capable of reaching most anticompetitive conduct. However, concern over class actions, treble damages awards, and costly jury trials have caused many courts in recent decades to limit the reach of antitrust. The result has been that some conduct harmful to consumers may be given a “free pass” under antitrust jurisprudence, not because the conduct is benign but out of a fear that the harm might be outweighed by the collateral consequences created by private enforcement. For this reason, we have seen an increasing amount of potentially anticompetitive conduct that is not easily reached under the antitrust laws, and it is more important than ever that the Commission actively consider whether it may be appropriate to exercise its full Congressional authority under Section 5.<sup>45</sup>*

Commissioner J. Thomas Rosch has offered a related explanation for his preference for the exclusive use of Section 5 in the case against Intel.<sup>46</sup> Section 5, Commissioner Rosch contends, is the appropriate antitrust weapon of choice against Intel because: (1) in markets with few players, like the microprocessor market, it is tough to distinguish harm to competitors from harm to competition; (2) the reduction of consumer (whether OEM or end user) “choice” warrants antitrust action even if the loss is not also associated with

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<sup>44</sup> See Herbert J. Hovenkamp, *The Federal Trade Commission and the Sherman Act*, available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1531136](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1531136); *FTC v. Sperry & Hutchinson Co.*, 405 U.S. 233, 239-244 (1972); Neil W. Averitt, *The Meaning of “Unfair Methods of Competition” in Section 5 of the Federal Trade Commission Act*, 21 B.C. L. REV. 227, 233, 251, 271 (1980).

<sup>45</sup> Statement of Chairman Leibowitz and Commissioner Rosch, *In re Intel Corp.*, Docket No. 9341 (Dec. 16, 2009), available at <http://www.ftc.gov/os/adjpro/d9341/091216intelchairstatement.pdf>.

<sup>46</sup> Concurring and Dissenting Statement of Commissioner J. Thomas Rosch, *In re Intel Corp.*, Docket No. 9341, available at <http://www.ftc.gov/os/adjpro/d9341/091216intelstatement.pdf>.

a reduction in output, increase in price, or some demonstrably-measurable competitive harm; (3) "course of conduct" monopolization claims are like "invitation to collude" cases and are therefore appropriate under Section 5; and (4) intent evidence is relevant in this case (and presumably most cases) and some cases interpreting the Sherman Act have restricted its use.<sup>47</sup>

Commissioner Rosch's proffered justifications reflect his own particular view that the strict requirements of Section 2 raise merely "technical" obstacles to antitrust claims that do not go to the core of the antitrust mission, thereby justifying further use of Section 5 to fill gaps where the Sherman Act does not reach some anticompetitive conduct. The fundamental problem with this approach, however, is that the development of Section 2 in response to error-cost concerns is a central feature of the Supreme Court's Sherman Act jurisprudence and *not* a mere technical sidelight. Nor is there any evidence that the Supreme Court's jurisprudence only arose in response to the possibility of private rights of action and follow-on suits. This account of Section 2 law is fundamentally flawed because it commits the basic error of conflating the *probability* of antitrust error --- or false positives --- with the *costs* of antitrust error.

The Supreme Court has consistently expressed concerns with not only the private rights of action and treble damages that exacerbate the costs of antitrust errors, but also the persistent and vexing problem at the heart of the monopolization enterprise: the inevitability of false positives and negatives that follows from the inherent difficulty in identifying and distinguishing anticompetitive conduct from pro-competitive conduct. Even without treble damages and private rights of action, the problem of false positives is a serious one. It simply does not follow from the observation that the Supreme Court has been concerned with the additional costs imposed by private rights of action that, if freed of those collateral consequences, the Commission is free to consider any deviation from its preferred competition policies and Section 2 as a "gap" to be filled under Section 5. The integration of error-cost concerns into Section 2 in decision after decision, by supermajority vote in each instance, should not be reversed by an end-run around the law by the Commission through a novel use of Section 5. Treating the error-cost principles embedded into the Sherman Act as the product of oversight from the Supreme Court, or as a defect to be evaded when convenient for the Commission's policy preferences, represents neither a coherent nor a principled approach to Section 5 in general or with respect to Intel in particular.

Commissioner Rosch's specific arguments in support of the application of Section 5 against Intel also necessarily fail. For example, the view that Commissioner Rosch espouses – that "the oft-repeated admonition that the Sherman and Clayton Acts protect competition, not competitors, and the federal courts' attendant disinclination

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<sup>47</sup> *Id.* For a comprehensive analysis of the pitfalls of intent evidence in antitrust cases, see Geoffrey A. Manne & E. Marcellus Williamson, *Hot Docs v. Cold Economics: the Use and Misuse of Business Documents in Antitrust Enforcement and Adjudication*, 47 ARIZ. L. REV. 609 (2005).

to protect competitors in cases brought under those statutes do not fit well"<sup>48</sup> in markets like the microprocessor industry with small numbers of competitors – implicitly rejects the notion that the “oft-repeated admonition” has consumer-welfare protecting value associated with it. Similarly, the second “justification” for expanded use of Section 5 – reaching conduct that harms “consumer choice” but does not reduce “consumer welfare” in the traditional sense – is a related attempt to dilute the requirement that plaintiffs demonstrate substantial anticompetitive harm.<sup>49</sup> The difficulty with distinguishing vigorous competition that harms competitors but benefits consumers from truly anticompetitive conduct is at the heart of error-cost analysis designed to harness the power of the antitrust laws to maximize the welfare benefits competition policy generates for consumers. If Commissioner Rosch truly believes that in markets with only one competitor, harm to that competitor renders harm to competition likely, a plaintiff should have little difficulty proving competitive harm under Section 2. Rosch’s argument turns the first principles of antitrust on their collective head.

Whatever the proper scope of Section 5, Commissioner Rosch’s argument fails by aggravating the very losses antitrust is designed to mitigate. First, in a market with few competitors, error-cost principles counsel the most caution in preventing false positives: if Intel actually impaired AMD’s ability to compete in the CPU market to the detriment of consumers, the “consumer harm” requirement is no barrier to the Commission; if it did not, antitrust liability is inappropriate. Put another way, where a market is largely dominated by a handful of firms, harm to competition – through higher prices and lower quality – should be the clearest as a consequence of a firm’s allegedly anticompetitive conduct. With fewer intervening firms to mitigate these effects, empirical data against Intel should be at its most readily available. If, however, there is no such evidence, neither theoretical speculation, “hot document” intent evidence,<sup>50</sup> nor generalized reference to consumer harm can justify imposing antitrust sanctions against Intel, as preventing a single competitor in a limited market from engaging in pro-competitive behavior is when the risk of consumer welfare losses stand at their very highest.

Commissioner Rosch’s argument represents, at its core, an appeal to the European “abuse of a dominant position” approach which more readily equates harm to competitors with harm to competition. The American system deliberately rejects this view. In addition to eliding established error-cost principles, the Commission’s approach offers business firms virtually no clarity with respect to which forms of business

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<sup>48</sup> *Id.*

<sup>49</sup> Indeed, the economics of exclusive dealing demonstrate that competition for exclusives, under a broad set of market conditions, and especially with sophisticated retail agents, will result in price reductions that more than offset losses associated with a reduction in product variety. See Benjamin Klein & Kevin M. Murphy, *Exclusive Dealing Intensifies Competition for Distribution*, 75 ANTITRUST L.J. 433 (2008).

<sup>50</sup> Manne & Williamson, *supra* note 47, at 646-47.

conduct are permissible. This problem is exacerbated by the fact that the Commission has ruled for itself in all 16 of the disputed Sherman Act cases it has brought.<sup>51</sup>

But most importantly, the Commission's use of Section 5 to circumvent perceived shortcomings in antitrust law is a problematic path, and one that will not improve antitrust law. First, as evidenced by Commissioner Rosch's defense, this view privileges the notions of the current Commission over the Supreme Court's interpretations of the Sherman Act. Second, this approach injects greater uncertainty into the antitrust law not only because it un-tethers Section 5 from antitrust law, but also because future Commissions might see different shortcomings. Third, adopting this approach will no doubt reduce the significant influence the Commission has enjoyed by developing sound antitrust principles through the common law process rather than evading them by invoking Section 5.

## **The Commission's Add-On Theories of Harm Involving Graphics Chips Suffer from Procedural and Substantive Flaws**

AMD's private suit against Intel and the enforcement actions of international antitrust agencies have focused on Intel's loyalty discounts with OEMs. As noted, the resolution of these allegations has taken the form of billions of dollars in fines and settlement payments, as well as an agreement between AMD and Intel that the latter would cease and desist from entering into any number of distribution contracts that were at the core of that litigation and the Commission's original investigation. The Commission's complaint is notable because, despite the resolution of the claims that have been the subject of earlier investigations and litigation, and significant fact-finding efforts, it has added new claims in its administrative complaint alleging that Intel maintained its monopoly in the x86 microprocessor market by excluding suppliers, such as Nvidia, of graphics products. A preliminary analysis of the substantive merits of these new claims reveals serious flaws, however, the add-on claims are most notable because of the Commission's break from prior practice in adding them without the benefit of thorough discovery and factual investigation.

## **Procedural Problems with the Commission's Add-On Claims**

The Commission's novel deviation from standard error-cost principles in the application of Section 5 against Intel is further complicated by the unusual break from standard Commission practice in bringing its complaint. The Commission's standard practice in bringing a complaint is to begin by conducting an investigation, often by requesting documents or deposing officers or employees of the investigated party. During that process, the Commission explains its competitive concerns and the investigated party

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<sup>51</sup> Statement of A. Douglas Melamed, Comments Submitted to Federal Trade Commission Section 5 Workshop (Oct. 14, 2008), available at <http://www.ftc.gov/os/comments/section5workshop/537633-00004.pdf>.

necessarily has a chance to respond both informally, through meetings with the agency's officials, and formally, through memoranda and white papers. Traditionally, it is only after this exchange that the FTC brings an enforcement action, and the FTC thereafter only pursues the case only so far as necessary for the public interest, often agreeing to a consent decree against the investigated company.

This give-and-take based on frank disclosure and reliance on agency good-faith and expertise is one of the very advantages cited by the Commission to distinguish itself from private parties and defend the controversial use of Section 5 to evade the Court's Section 2 jurisprudence, developed to rein in problematic private plaintiffs.<sup>52</sup> Accordingly, and laudably, the Commission does not typically treat administrative enforcement proceedings as a private plaintiff might regard their case; that is, the Commission looks to act for the public interest, while a private plaintiff simply seeks to press any advantage against an adverse party.

But the Commission's actions against Intel thus far with respect to the invert nearly all of these norms. The Commission resisted Intel's requests for specific details on the Commission's concerns until late in the investigation. Rather than invite Intel to defend its practices during the investigatory stages, the staff presented the Commission with a recommendation to sue even as Intel prepared expert reports relevant to the Commission's decision in its litigation with AMD. In turn, the Commission is now demanding far-reaching remedies, including forced licensing of billions of dollars of intellectual property, prior to taking discovery from Intel. This model – sue first, making a colossal demand, and then negotiate through discovery – is familiar to private plaintiffs.

Such an approach may be appropriate in private actions. It squanders, however, the inherent expertise and neutrality justifying administrative enforcement of the FTC Act in the first place. Several Commissioners have recognized the problems of private antitrust plaintiffs and the excessive costs that they impose upon firms in enforcing the antitrust laws. Accordingly, the logic goes, the Commission, as a neutral, expert agency, is better positioned to enforce the antitrust laws to maximize consumer welfare. Yet the Commission – and Commissioner Rosch's – attitude towards Intel breaks sharply from the conduct these prior comments reflect. Commissioner Rosch's stated goal in future complaints is to impose a "willingness on the part of staff to conduct more discovery post-complaint, just like litigators do in federal and state court litigation."<sup>53</sup> By acting as a private plaintiff might – adversarial to the investigated firm – the Commission disposes of the primary efficiencies of its expertise as an agency. Further, the costs of private

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<sup>52</sup> Statement of J. Thomas Rosch, *In re Intel Corp.*, Docket No. 9341, 2 (Dec. 16, 2009) ("Section 5 is the most appropriate vehicle for the analysis, and the Commission, with its expertise and experience, is the most appropriate plaintiff to make that determination."). Commissioner Rosch similarly contends that the Commission's expertise and experience "make it a more dispassionate and superior judge" of intent evidence than lay juries in a Section 2 case. *Id.*

<sup>53</sup> Interview by Mark D. Whitener with J. Thomas Rosch, Commissioner, Fed. Trade Comm'n (Jan. 26, 2009), available at <http://www.ftc.gov/speeches/rosch/090126abainterview.PDF>.

suits are only mildly ameliorated; the use of Section 5 leaves a targeted firm vulnerable to "follow-on" suits at the state level under state consumer protection laws.<sup>54</sup>

This shift in procedures appears motivated by the Commission's desire to shift case law away from the error-cost framework. Chairman Leibowitz has commented that the Commission faces a "federal judiciary . . . that is hostile to vigorous enforcement of the antitrust laws."<sup>55</sup> Accordingly, Commissioner Rosch feels that the Commission's actions "should not be tied by the more technical definitions of consumer harm that limit applications of the Sherman Act."<sup>56</sup> This liberty with established antitrust principles, however, is most dangerous precisely in the administrative context – where the Commission sits as prosecutor, judge, and jury.

This shift is problematic because of the fundamental differences between the incentives within, and legal relationships following, administrative and adversarial proceedings. Administrative bodies enjoy extremely broad latitude to investigate, craft, and even try their own cases; the logic in allowing this centralization of control, as Commissioner Rosch has stated repeatedly, is that agencies are both detached from private interests and enjoy substantial expertise in their fields. Accordingly, agencies are free to make unpopular decisions rooted in their expertise in pursuit of the public interest. Adversarial proceedings enjoy a number of procedural protections because an adversarial plaintiff is required – constitutionally required – to have a personal, private stake in the outcome of the litigation. The Commission's behavior against Intel combines the lack of procedural safeguards inherent in an administrative proceeding with the private interests of the Commission's ideological motives to bludgeon Intel with a novel and controversial use of Section 5.

Nor is the fact Section 5 cannot be prosecuted privately any consolation. A traditional Section 2 prosecution by the Commission often gives rise to follow-on actions by private plaintiffs for treble damages. The Commission assures critics that its use of Section 5 inherently requires fewer error-cost protections because there are no follow-on suits by private plaintiffs permitted under Section 5.<sup>57</sup> This sentiment is myopic at best. Nearly every state has enacted a relevant consumer protection act statute, and, as noted, the Commission's imposition of liability would expose Intel and other firms found liable

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<sup>54</sup> See Dissenting Statement of Commissioner William E. Kovacic, In the Matter of Negotiated Data Solutions, LLC, File No. 051-0094 (January 23, 2008) ("By statute or judicial decision, courts in many states interpret the state UMC and UDP laws in light of FTC decisions, including orders. As a consequence, such states might incorporate the theories of liability in the settlement and order proposed here into their own UMC or UAP jurisprudence. A number of states that employ this incorporation principle have authorized private parties to enforce their UMC and UAP statutes in suits that permit the court to impose treble damages for infringements.").

<sup>55</sup> *Id.*

<sup>56</sup> *Id.*

<sup>57</sup> Interview by the Wall Street Journal with Jon Leibowitz, Chairman, Fed. Trade Comm'n (January 31, 2010), available at [http://online.wsj.com/article/SB10001424052748704722304575037572444983454.html?mod=WSJ\\_topics\\_obama](http://online.wsj.com/article/SB10001424052748704722304575037572444983454.html?mod=WSJ_topics_obama).

under Section 5 to follow-on suits at the state level under these CPA claims.<sup>58</sup> Thus, while the additional lawsuits would not strictly fall under the antitrust laws, they present the same problems, and counsel in favor of the same error-cost protections. The Commission's justifications for its expansion of Section 5 fail to address this point.

## Substantive Problems with the Commission's Add-On Claims

As noted, the Commission's Complaint now includes allegations that Intel excluded Nvidia from chipsets with integrated graphics that are compatible with Intel's new generation of CPUs. For example, the Commission alleges that:

*GPUs are a threat to Intel's monopoly in the relevant CPU markets. GPUs are adding more CPU functionality with each product generation. GPU manufacturers, such as Nvidia and AMD, through its affiliate, ATI, are developing General Purpose GPUs and programming interfaces that threaten Intel's control over the computing platform. This General Purpose GPU computing ("GP GPU") platform has the potential to marginalize Intel's long-standing CPU-centric, x86-based strategy. Currently, both high-performance computing and mainstream applications and operating systems are beginning to adopt GP GPU computing functionality.*<sup>59</sup>

The Commission also alleges that "GPUs also could facilitate new entry or expansion in the relevant CPU markets by other firms, such as Nvidia, AMD, or Via,"<sup>60</sup> and that Intel has responded to this competitive threat with a variety of tactics including making allegedly misleading and deceptive statements, discounts, unlawful bundling, and "degradation" of the interconnection between the microprocessor and discrete GPUs.<sup>61</sup>

The Commission's Complaint goes so far as to make the allegation that Intel's conduct created a "duty to deal" with its chief rivals.<sup>62</sup> Only in extreme circumstances do the antitrust laws impose a duty to deal with competitors or require disclosure of confidential product development plans to rivals. The Commission's Notice of Contemplated Relief indicates that the Commission will require "Intel to make available technology (including whatever is necessary to interoperate with Intel's CPUs or chipsets) to others, via licensing or other means, upon such terms and conditions as the Commission may order, including but not limited to extensions of terms of current

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<sup>58</sup> Commissioner Kovacic made this point in his dissent to the Commission's controversial application of Section 5 in *N-Data*. *supra* note 54 ; see also Searle Civil Justice Institute, State Consumer Protection Acts: An Empirical Analysis of Private Litigation (December 2009), available at [http://www.law.northwestern.edu/searlecenter/uploads/CPA\\_Proof\\_113009\\_final.pdf](http://www.law.northwestern.edu/searlecenter/uploads/CPA_Proof_113009_final.pdf).

<sup>59</sup> *In re Intel Corp.*, No. 9341 ¶ 16 (Fed. Trade Comm'n, Dec. 16, 2009).

<sup>60</sup> *Id.* at ¶ 17.

<sup>61</sup> *Id.* at ¶ 18.

<sup>62</sup> *Id.* at ¶ 21.

licenses."<sup>63</sup> The audacity of the contemplated relief cannot be overstated, as the license to Nvidia would involve the patents at the core of Intel's x86 microprocessor architecture, and thus at the core of its business.

The Commission's remedy also awkwardly seeks to compel Intel to license its patents to create a new competitor in the x86 microprocessor market to remedy allegedly exclusionary conduct related to graphics products. The Commission's cavalier approach to the duty to deal in this case runs afoul of the approach it has advocated in the international antitrust community, not to mention the first principles of antitrust that provide the foundation for the Supreme Court's skeptical view of compulsory licensing.<sup>64</sup> Again, the Commission's approach threatens to use Section 5 to make an end run around longstanding judicial authority based on the idiosyncratic views of the current Commission concerning shortcomings in existing antitrust law.

The Commission's theory of competitive harm involving graphics products has not been well specified, no doubt in part due to its late addition to the Complaint without the benefit of discovery. However, the Commission's allegations involving graphics products do not appear to generate substantial antitrust concerns. The fundamental flaw is that the Commission's apparent theories relate to how Intel's conduct affects chipsets with integrated, basic graphics capabilities--but, unfortunately for the Commission, these chipsets are not the Nvidia products that could potentially pose a competitive alternative to x86 microprocessors.<sup>65</sup> Nvidia is simply not challenging x86-based computing through chipsets with integrated graphics, which have suffered as a result of the integration of graphics capabilities onto the microprocessor itself. The single theory articulated by the Commission – and it is a mere unsupported allegation – that could potentially identify a competitive impact on x86-based computing is that Intel has “degraded” the interconnection between the microprocessor and discrete GPUs. However, that interconnection is provided by an industry standard, and the Commission will bear the burden of demonstrating that Intel degraded the industry standard connection.

The Commission's concerns with graphics products otherwise appear to involve complaints that Intel deceived Nvidia about its plans to integrate various functions into the microprocessor. Again, it bears repeating that the antitrust laws very rarely impose such a duty to deal with rivals at all, much less to disclose competitively-sensitive information.<sup>66</sup> Further, and as discussed, alleged deception relating to Nvidia's chipset

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<sup>63</sup> *In re Intel Corp.*, Notice of Contemplated Relief, No. 9341 ¶ 17 (Fed. Trade Comm'n, Dec. 16, 2009).

<sup>64</sup> *Verizon Commc'ns v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398, 407-08 (2005) (“compelling such firms to share the source of their advantage . . . may lessen the incentive for the monopolist, the rival, or both to invest in . . . economically beneficial facilities.”)

<sup>65</sup> Nvidia's potential challenges to the x86 microprocessor market involve either high-performance discrete graphic processing units (GPUs) or low-power application, “system-on-a-chip” solutions.

<sup>66</sup> In *Berkey Photo, Inc. v. Eastman Kodak Co.*, 603 F.2d 263 (2d Cir. 1979), Chief Judge Kaufman explained the rationale for the extreme reluctance to impose such a duty on firms in rejecting plaintiff's claim that the defendant's failure to *disclose in advance* plans to introduce a new product was an anticompetitive act,

business simply cannot logically form the basis of the Commission's monopolization allegations in the market for x86 microprocessors.

## Conclusion

The purpose of requiring actual consumer harm in complaints like the one against Intel is simple: antitrust law sensibly prefers the "bird in the hand" of current lower prices and higher quality over the more speculative "bird in the bush" of possible future lower prices. This preference lies at the heart of error-cost principles, embedded deeply into the development and application of antitrust law in the United States: that unduly chilling pro-competitive conduct is as likely, even more likely, to harm consumer welfare than occasionally failing to prosecute anticompetitive conduct. Unlike the Commission's complaint, this is neither a novel nor radical theory of antitrust law; the Supreme Court has supported error-cost principles unanimously and forcefully for decades. The result has been a shift away from the haphazard, embarrassingly inconsistent body of antitrust law in the 1960s towards a more economically-disciplined, rigorous, and effects-based antitrust.

Consumers stand to lose from this application of Section 5. Rather than applying Section 5 to fill gaps in the antitrust laws, the Commission seeks to use Section 5 to countermand or undermine what it views as difficult precedent for it to overcome. But the Commission does not stand to lose from uprooting the welfare-preserving error-cost framework--consumers do. Contrary to assertions that Section 5 does not have collateral consequences, firms will in fact forego pro-competitive behavior out of fear of antitrust and consumer protection liability. Further, the novel use of Section 5 power against Intel will properly be seen as boundless, and firms will refrain from welfare-enhancing discounts and other pro-consumer behavior accordingly. Firms will bear this uncertainty in the form of increased prices and reduced quantity and quality in products, which will ultimately be shifted to consumers. The Commission's Intel complaint thereby represents both an inversion of the antitrust laws in intention and result.

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noting that "We must always be mindful lest the Sherman Act be invoked perversely in favor of those who seek protection against the rigors of competition.").

**Table 1**  
**AMD Microprocessor Gross Margins, Q1 2004 - Q4 2009**

Quarter	AMD Microprocessor <sup>1</sup> Gross Margin	Sources
Q1 2004	51.2%	[a], [b]
Q2 2004	52.4%	[a], [c]
Q3 2004	52.1%	[a]
Q4 2004	50.0%	[d]
Q1 2005	52.7%	[e]
Q2 2005	58.0%	[i]
Q3 2005	55.4%	[g]
Q4 2005	57.3%	[e]
Q1 2006	58.5%	[f]
Q2 2006	56.8%	[f]
Q3 2006	52.0%	[h]
Q4 2006	45.2%	[e], [f], [h], [j], [l], [m], [n]
Q1 2007	35.6%	[e], [f], [h], [j], [l], [m], [n], [k]
Q2 2007	37.9%	[e], [f], [h], [j], [l], [m], [n], [k]
Q3 2007	46.0%	[e], [f], [h], [j], [l], [m], [n], [o]
Q4 2007	49.2%	[e], [f], [h], [j], [l], [m], [n], [p]
Q1 2008	46.9%	[e], [f], [h], [j], [l], [m], [n], [q]
Q2 2008	40.8%	[e], [f], [h], [j], [l], [m], [n], [r]
Q3 2008	50.6%	[e], [f], [h], [j], [l], [m], [n], [s]
Q4 2008	48.9%	[e], [f], [h], [j], [l], [m], [n], [t]
Q1 2009	38.8%	[e], [f], [h], [j], [l], [m], [n], [u]
Q2 2009	30.3%	[e], [f], [h], [j], [l], [m], [n], [v]
Q3 2009	42.9%	[e], [f], [h], [j], [l], [m], [n], [w], [x]
Q4 2009	47.3%	[e], [f], [h], [j], [l], [m], [n], [y], [z]

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