# FTC Files Suit Against Intel

## *U.S. Government Challenges Intel Business Practices*

*by Linley Gwennap*

Attempting to define the appropriate business practices of a company with monopoly power, the U.S. Federal Trade Commission (FTC) has filed a suit against microprocessor giant Intel, alleging anticompetitive behavior that is illegal under federal law. Intel quickly responded that it believes its actions have been consistent with existing case law, and that the FTC is creating "a new legal theory" to deal with this case.

If the FTC prevails in its case, it would clarify the responsibilities of technology companies—such as Intel, Microsoft, and Cisco—with dominant market shares. The government asserts that such companies cannot cut off the supply of information and products to customers unless the action serves a "legitimate, procompetitive purpose." In at least three situations, Intel took actions that the FTC deems anticompetitive.

While Intel will fight the case, the penalty for losing is not severe. The FTC is asking only that Intel "cease and desist from directly or indirectly discriminating" against its customers with regard to supplying advance product information, prototypes, and actual products. We doubt that such a course of action would cause Intel to lose a significant amount of business to its competitors.

### Intel Freely Admits Actions

This case is unusual in that Intel freely admits to most of the allegedly illegal actions. The FTC has built its filing around three interactions between Intel and its customers. In the first case, Digital lost access to Intel's technical information and prototype processors after it sued Intel for patent infringement (see MPR 6/2/97, p. 16). Had Digital not come to a settlement with Intel (see MPR 11/17/97, p. 1), this situation could have prevented Digital from developing viable systems that used Intel chips.

Intel took similar action against Intergraph when that company attempted to assert its own patents against some of Intel's customers (see MPR 12/8/97, p. 4). Like Digital, Intergraph couldn't develop new products until Intel was forced by a federal judge (see MPR 5/11/98, p. 16) to supply the necessary information.

The FTC's third example involves Compaq, which sued Packard Bell, another PC maker, in 1994 in a dispute over motherboard patents. Packard Bell, which was using motherboards purchased from Intel, asked Intel to indemnify, or protect, it from Compaq's suit. Intel then went to Compaq seeking rights to Compaq's motherboard patents and, when the PC maker refused to cede them, cut off its access to technical information.

Compaq extended its lawsuit to cover Intel as well as Packard Bell, but the companies eventually came to a settlement. Like Digital, Compaq acceded to Intel's demands, licensing its patents rather than attempting to compete without Intel's support.

Intel doesn't deny the basic facts that it withdrew from these companies access to technical information on unreleased products (books with yellow, orange, or red covers, collectively known as "color books") and prototypes of these products. The color books and prototypes are controlled under nondisclosure agreements (NDAs), so Intel simply terminated these agreements. The company says it has "the legal right to assert its intellectual property rights as a defense to an attack on its core microprocessor business."

In the Digital case, Intel responded to a surprise lawsuit that requested Intel to stop shipping most of its products. In the Intergraph and Compaq cases, however, Intel terminated the NDAs before those companies filed suit. Compaq never threatened Intel's core microprocessor business; its suit was focused on motherboard issues.

### FTC Stretches Antitrust Doctrine

In any case, the FTC believes Intel had no right to terminate NDAs in these circumstances. Although Intel will not admit to being a monopolist, the company's market share is universally agreed to be 80% or more, well within the range that is generally considered to be a monopoly. In issuing an injunction in the Intergraph case, Judge Edwin Nelson found that "Intel has monopoly power in the relevant market of high-performance CPUs."

Market share is not the only criterion in being declared a monopolist. The ability to set prices and to control the market are key factors. Intel's lawyers claim the company's recent price cuts (see MPR 6/22/98, p. 5) are a response to competition, although in other public forums the company rarely mentions competition as a reason for cutting its prices.

Intel's control over the market is frequently demonstrated, most recently by PC makers' transition from Socket 7 to Slot 1, which is occurring rapidly despite opposition from Intel's competitors and even some of its customers. This transition also leaves Intel open to charges that it has a monopoly in Slot 1 processors, due to its 100% share in this market segment.

It is not illegal to be a monopolist. But under the Sherman Antitrust Act, the Federal Trade Commission Act, and subsequent case law, it is illegal to use monopoly power to entrench a monopoly or to restrain competition. By using its monopoly power to extort patent licenses from its customers, Intel is acting illegally, says the FTC.

Case law, however, is not clear on this point. Antitrust law has generally been used to prevent monopolists from harming their competitors, not their customers. Proving restraint of trade in this case may be difficult.

One argument is that Intel's actions reduce competition in the systems market by preventing companies such as Intergraph from building viable products. Intel points out, however, that eliminating one of many system vendors will not perceptibly reduce the overall level of system competition. Although this treatment is harsh on a particular system maker, the impact on system buyers is negligible.

The FTC filing makes passing reference to the harm done to the targeted system vendors, but its key argument is different. The filing asserts that Intel's coercive actions will "diminish the incentives of the industry to develop new and improved microprocessor and related technologies." Thus, this conduct "reduces competition to develop … future generations of microprocessor products."

This argument seems odd, however, since neither Compaq nor Intergraph were developing microprocessor products that might compete with Intel's. Digital's Alpha processors do compete with Intel's chips, but Intel's actions threatened Digital's x86-based business, not its Alpha-based business. Compaq and Intel compete in the motherboard arena, but the FTC focuses on the microprocessor market.

A third argument is that Intel gains a market advantage over its real competitors, such as AMD and Cyrix, by obtaining patent rights from its customers in a manner that its smaller rivals can't duplicate. In this way, Intel can gain access to more intellectual property than its competitors can. The FTC filing, however, does not include this argument.

## First Step Is Administrative Proceeding

After voting 3-1 to pursue the suit, the FTC now turns the case over to an FTC administrative law judge, making the case an internal matter. Although the administrative judge performs many of the same functions as a federal judge, the proceeding is simpler than a full trial and is not allowed to last more than 12 months. At the completion of the proceeding, the judge will make a recommendation to the FTC commissioners, who will then vote on whether to accept it.

If the FTC votes to sanction Intel, it can order "necessary and appropriate relief." Its filing outlines specific requests, mainly that Intel must provide color books, prototypes, and products in a similar fashion to "similarly situated" customers. It requests that Intel not cut off any customer without "a legitimate business consideration." Issues of intellectual-property disputes or competitive positions of the customer are not considered legitimate reasons to stop serving a customer.

Intel says it will contest the FTC's action through the administrative proceeding and ultimately appeal its decision to a federal court, if necessary. Although the initial proceeding must be completed by the middle of 1999, an appeal could stretch out the timing of any sanctions.

### For More Information

For a copy of the FTC's filing against Intel, access the Web at *www.ftc.gov/os/9806/intelfin.cmp.htm*.

## New Legal Interpretations Required

In deciding this case, the administrative judge (and potentially a federal appeals judge) has a difficult task. As noted, most of the basic facts are not in dispute, only the legal theory. In Intel's favor, existing antitrust precedents do not seem to apply here. Antitrust experts, even those who favor the FTC's position, could not point to a previous case where a company was sanctioned for mistreating customers. Although Intel's actions have clearly not been "procompetitive," that does not necessarily make them anticompetitive.

The FTC did not raise the "essential facility" argument in its filing, but this concept could arise during the proceeding. In the Intergraph hearing, Judge Nelson found that Intel's processors are essential to the viability of its customers, just as electricity and phone service are essential.

The classic case of an essential facility is a railroad bridge that was the only way across the Mississippi River. The railroad company that built it was forced to provide access to its competitors, because the bridge was an essential facility. In this case, the law forced an increase in direct competition. It did not affect the railroad's dealings with its customers, which would make it more applicable to the Intel case.

The basic antitrust laws, however, are very broad. The Sherman Act is only two paragraphs long, and its essence is to prevent a monopolist from restraining competition. The Act does not describe what constitutes a restraint of competition; this vagueness gives judges much leeway in interpreting the law.

The judge, like many observers, may take a dim view of Intel's heavy-handed tactics. Although removing one of many competitors from the PC or workstation market may do little to reduce overall competition, giving Intel the power to destroy another company's business seems unfair. A judge who feels Intel has been unfair, however, must still find a defensible legal precedent on which to base a ruling.

## Intel May Choose to Settle

Although it might prevail in court, Intel is likely to settle this case, potentially after the initial proceeding but before the final decision. The cost to Intel of modifying its business practices is small, and a settlement could allow it to make "voluntary" changes to its business practices.

If Intel is found to be a monopolist, however, the finding would open the door to further lawsuits from the FTC and from Intel's competitors. These suits could attack Intel's moves in secondary markets such as system logic, motherboards, and graphics. The potential for onerous restrictions in these areas is a danger Intel can't afford to face. M