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AMD'S LAWSUIT CHALLENGES INTEL'S PROCOMPETITIVE PRICE DISCOUNTING – THE VERY CONDUCT THE ANTITRUST LAWS ENCOURAGE

I. INTRODUCTION

AMD’s challenge to Intel’s competitive conduct, at its core, is a complaint about the legality of Intel’s pricing practices. AMD is complaining about Intel’s aggressive pricing – specifically the discounts and rebates Intel provided to its customers to win their business. Although AMD’s couches its complaint in the colorful rhetoric of “bribes” and “punishment,” it is not a bribe to offer lower prices to customers to get them to buy more Intel microprocessors and it is not punishment to reduce discounts to customers that buy less from Intel and more from AMD. It is price competition.

The antitrust laws exist to protect consumers – by ensuring consumers get the best possible products at the lowest possible prices. The antitrust laws do not protect competitors from aggressive, relentless competition – to the contrary, the antitrust laws affirmatively encourage such competition. Far from being anticompetitive, competing hard – and negotiating aggressively – to convince a customer to buy your products and not your competitor’s is what competition is all about. Providing discounts and rebates to win business is procompetitive. Competing to win – and winning – all of a customer’s business is procompetitive. That’s what Intel did.

The problem with AMD's accusation is that, while Intel competed aggressively by offering attractive prices to win as much business as it could, it always priced its microprocessors above cost, after taking into account all discounts, rebates and other price concessions. AMD's claim grounded on Intel's pricing runs headlong into two decades of Supreme Court jurisprudence that unswervingly treats above-cost price competition as *per se* lawful – the antitrust equivalent of free speech under the First Amendment.

In a series of six decisions spanning more than 20 years, remarkable for their unwavering clarity and consistency, the Supreme Court has repeatedly rejected any antitrust challenge to above-cost price cutting, regardless of the form that it takes. In these decisions, the Supreme Court established the bright-line principle, based on a simple price-cost test, that above cost price cutting never can violate the antitrust laws. Further, the Court has made it clear that the price-cost test governs all pricing conduct, without exception. Decisions of the Courts of Appeals following the Supreme Court's mandate have made it equally plain that framing pricing conduct as a loyalty rebate, market share discount, or exclusive dealing does not permit a competitor suing under the antitrust laws to avoid the price-cost test. This firmly established principle of antitrust law precludes the imposition of antitrust liability for Intel's discounting practices because Intel's discounts were always comfortably above cost.

II. THE SUPREME COURT'S BRIGHT LINE LEGAL STANDARD: ABOVE-COST PRICE CUTTING IS *PER SE* LEGAL

In its 1986 decision in *Matsushita*, which involved claims of a conspiracy to drive competitors out of business by pricing below cost, the Supreme Court explained that "cutting prices in order to increase business often is the very essence of competition." *Matsushita Elec. Indus. Co. v. Zenith Radio Corp*., 475 U.S. 574, 594 (1986). The Court said that "mistaken inferences" of anticompetitive effects "are especially costly" in cases involving discounting "because they chill the very conduct the antitrust laws are designed to protect." *Id*. It cautioned that "[w]e must be concerned lest a rule or precedent that authorizes a search for a particular type of undesirable pricing behavior end up by discouraging legitimate price competition." *Id*.

(quoting *Barry Wright Corp. v. ITT Grinnell Corp.*, 724 F.2d 227, 234 (1st Cir. 1983) (Breyer, J.)).

That same year, in *Cargill, Inc. v. Monfort of Colo., Inc.*, 479 U.S. 104 (1986), the Court rejected an antitrust claim that a merged company would drive a competitor out of business by lowering its prices "to some level at or slightly above its costs." *Id*. at 114. In words that apply with equal force to AMD's claims against Intel, the Court said that it would be a "perverse result" to hold illegal a "decision by a firm to cut prices in order to increase market share" when the firm's prices are above cost. *Id.* at 116.

Four years later, in *Atlantic Richfield*, in addressing a claim that a price ceiling weakened competitors by forcing them to reduce their prices and drove many rivals out of business, the Court affirmed again that, "in the context of pricing practices, only predatory pricing has the requisite anticompetitive effect." 495 U.S. at 339. Underscoring the broad reach of this principle, the Court said that "[l]ow prices benefit consumers *regardless of how those prices are set*, and so long as they are above predatory levels, they do not threaten competition." *Id.* at 340 (emphasis added). To leave no doubt regarding the breadth of this principle, the Court said that "[w]e have adhered to this principle *regardless of the type of antitrust claim involved*." *Id*. (emphasis added).

The Supreme Court reiterated these points in its seminal 1993 decision in *Brooke Group*, which involved a claim of price cutting targeted at a rival's largest customers to punish the rival for its own discounting. In that decision, the Court affirmed again that the *only* pricing conduct that is subject to antitrust scrutiny is below-cost pricing. It stated: "The mechanism by which a firm engages in predatory pricing – lowering prices – is the same mechanism by which a firm stimulates competition; because cutting prices in order to increase business often is the very essence of competition . . . mistaken inferences . . . are especially costly, because they chill the very conduct the antitrust laws are designed to protect." *Id.* at 226 (internal quotations omitted). *See also Verizon Commc'ns Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398, 414 (2004). *Brooke Group* repeated the admonition that low prices benefit consumers regardless of how they are set, and emphasized again that above-cost prices are unassailable "regardless of the type of antitrust claim involved." 509 U.S. at 223.

The Supreme Court, in *Brooke Group*, considered and rejected alternatives to a price-cost test. It stated that "the exclusionary effect of prices above a relevant measure of cost either reflects the lower cost structure of the alleged predator, and so represents competition on the merits, or is beyond the practical ability of a judicial tribunal to control without courting intolerable risks of chilling legitimate price-cutting." *Id*. *See also Trinko,* 540 U.S. at 414.

In 2007 the Court reaffirmed both the authority of the price-cost test and the breadth of its reach in *Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co.*, 549 U.S. 312 (2007), which involved a claim of predatory buying that drove a competitor out of business. There the Court emphasized yet again that prices above predatory levels do not threaten competition, and that low, nonpredatory prices "benefit consumers regardless of how those prices are set." 549 U.S. at 319. *Weyerhaeuser* also affirmed that the *Brooke Group* standard governs *all* claims of the "deliberate use of unilateral pricing measures for anticompetitive purposes." *Id*. at 322. *Weyerhaeuser* left no room for argument that the manner in which the prices are set, such as whether a discount is linked to the expectation of increased purchases by a customer, dilutes the unbending principle that above-cost price discounting is procompetitive.

Again, in 2009, in *Pacific Bell Telephone Co. v. Linkline Commc'ns, Inc.,* 129 S. Ct. 1109 (2009), which involved a claim that the defendant had engaged in a "price squeeze" to drive up competitors' costs, the Supreme Court reaffirmed its teachings regarding the bright line price-cost test that governs all pricing-related claims. "To avoid chilling aggressive price competition, we have carefully limited the circumstances under which plaintiffs can state a Sherman Act claim by alleging that prices are too low. Specifically, to prevail on a predatory pricing claim, a plaintiff must demonstrate that: (1) 'the prices complained of are below an appropriate measure of its rival's [the defendant's] costs'; and (2) there is a 'dangerous probability' that the defendant will be able to recoup its 'investment' in below-cost prices." *Id*. at 1120 (quoting *Brooke Group*, 509 U.S. at 222-24).

Thus, the only relevant question with respect to Intel's pricing-based competitive actions is whether Intel has priced its microprocessors below cost. Theories of anticompetitive harm attributable to above-cost pricing cannot pass muster, whether or not the pricing disadvantaged AMD. AMD's attempt to avoid the price-cost test by recasting Intel's discounts as payments for exclusion is unavailing. The governing legal standard cannot be changed through legerdemain. As the Sixth Circuit held with respect to payments made by 3M to secure exclusive distribution, "[i]f the up-front payments, when combined with the price terms that 3M offered each of these large retailers, 'are not predatory, any losses flowing from them cannot be said to stem from an *anticompetitive* aspect of defendant's conduct.'" *NicSand, Inc. v. 3M Co.*, 507 F.3d 442, 452 (6th Cir. 2007) (en banc) (quoting *Atl. Richfield*, 495 U.S. at 340-41). As *Brooke Group* makes clear, even recasting Intel's pricing practices as acts of malice would be unavailing, as "[e]ven an act of pure malice by one business competitor against another does not, without more, state a claim under the federal antitrust laws . . . ." 509 U.S. at 224. In a pricing case, that "more," as the Supreme Court decisions have made clear repeatedly, is pricing below cost.

A. Failure to Strictly Adhere to The Price-Cost Test Poses an Unacceptable Risk of Inhibiting Price Competition That Benefits Consumers

The driving principle behind the Supreme Court's decisions in the pricing arena has been the commonsense concept that low prices that are set to win business, and take market share from competitors, are beneficial to consumers in all but extraordinary cases, and that antitrust rules must avoid discouraging price cutting, which is the essence of competitive activity. The Supreme Court has repeatedly rejected theories of harm from above-cost pricing because they place undue demands on legal tribunals and thereby pose the intolerable risk of inhibiting legitimate price competition. *Brooke Group,* 509 U.S. at 223; *Weyerhaeuser*, 549 U.S. at 325; *Linkline,* 129 S. Ct at 1120.

Justice Stephen Breyer explained the logic that underlies antitrust law in the pricing area as follows: "[L]aw is an administrative system the effects of which depend upon the content of rules and precedents only as they are applied by judges and juries in courts and by lawyers advising their clients. Rules that seek to embody every economic complexity and qualification may well, through the vagaries of administration, prove counter-productive, undercutting the very economic ends they seek to serve. . . . [W]e must be concerned lest a rule . . . that authorizes a search for a particular type of undesirable pricing behavior end up by discouraging legitimate price competition." *Barry Wright*, 724 F.2d at 234 (Breyer, J.). This concern underpins modern antitrust jurisprudence. Absent a bright line standard that can be applied by businesses and their legal advisers in real time, procompetitive discounting will be inhibited, to the detriment of the very consumers whom the law sets out to protect. Any effort to avoid a price-cost test represents, of course, an attempt to reject the immediate benefits of Intel's discounts for a promise that consumers will somehow benefit in the future from less aggressive price competition in the present time. This is a tradeoff that the law does not tolerate.

As the author of the leading antitrust treatise observed, abandoning a bright line price-cost test in favor of promises of more competition based on more elastic standards can only serve to chill the very price competition the antitrust laws should encourage:

> The great majority of discounting practices are procompetitive. Discounts are the age-old way that merchants induce customers to purchase from them and not from someone else or to purchase more than they otherwise would. The vast majority of them reflect hard bargaining. Many are explained by economies of scale or scope in either manufacturing or transacting. Some, such as market share or quantity discounts, aid sellers in long-run output planning. Nearly all are output increasing, and thus procompetitive. The economic modeling showing that certain discounts can be anticompetitive tends to be highly complex, often making unrealistic assumptions. The result can be proposed legal standards that make impossible informational demands on courts. . . . A federal court could never apply such theories, particularly in a jury trial, without creating the 'intolerable risk' that the Supreme Court feared in *Brooke Group*, of chilling procompetitive behavior.

Herbert Hovenkamp, *Discounts and Exclusion*, 3 Utah L. Rev. 841, 843 (2006).

Accordingly, the leading antitrust treatise states that "when a discount is offered on a single product, such as a quantity or a market share discount, the discount is ordinarily lawful if the price after all discounts are taken into account exceeds the defendant's marginal cost or average variable cost. Such discounts . . . are covered by antitrust's ordinary predatory pricing rule." 3A Philip E. Areeda & Herbert Hovenkamp, ANTITRUST LAW ¶ 749a at 309-10 (3d ed. 2008) (hereinafter "Areeda & Hovenkamp"). The treatise observes that the reason for the courts' adoption of the price-cost test in the predatory pricing area is that "as long as prices are above the relevant measure of cost, the discounts cannot exclude an equally efficient rival" and that "[t]he same thing is true of single-product discounts." *Id*. at 310. "As a result, above-cost discounts on single products should be regarded as lawful." 3B Areeda & Hovenkamp, ¶ 768b at 169.

To the extent that AMD may be disadvantaged by Intel's above-cost discounts, it is disadvantaged because it is less efficient, and the law offers no succor to a competitor that loses to a more efficient competitor. As Judge Posner explained, "[i]t would be absurd to require the firm to hold a price umbrella over less efficient entrants. . . . [P]ractices that exclude only less efficient firms . . . are not actionable, because we want to encourage efficiency." Richard A. Posner, ANTITRUST LAW 196 (2d ed. 2001). *See LePage's Inc. v. 3M*, 324 F.3d 141, 155 (3d Cir. 2003) (en banc) (citing equally efficient competitor standard with approval). *See also Cascade Health Solutions v. PeaceHealth*, 515 F.3d 883, 906-09 (9th Cir. 2008); *Concord Boat Corp. v. Brunswick Corp.*, 207 F.3d 1039, 1061 (8th Cir. 2000); *Barry Wright*, 724 F.2d at 232.

The law does not protect less efficient rivals from the rigors of price competition. It is the market system that determines winners and losers based on efficiency. Whenever a company wins a sale and a rival loses it, the rival is "excluded" from making the contested sale. This outcome is the ordinary and expected consequence of competition, and has no antitrust significance. If a company wins with an above-cost price, it is not meaningful to speak about exclusion because the "exclusion" is the normal competitive consequence of one firm's superior efficiency over that of its rival. If a price offer can be matched by an equally efficient competitor, the offer cannot exclude competition other than on the normal basis on which competition is conducted, which is efficiency. The form of the price offer – such as whether the price is linked to winning a specific volume or share of the customer's business – is irrelevant. The winning company's success over its rival is indistinguishable from any other success that results from one firm's greater efficiency than its rival's.

Nor can the price-cost test be avoided by claiming that the conduct at issue constitutes or causes "foreclosure." The "foreclosure" label is not a free pass that relieves an antitrust claimant of the rigors of proving below-cost pricing. As Justice Breyer observed, "virtually *every* contract to buy 'forecloses' or 'excludes' alternative sellers from *some* portion of the market, namely the portion consisting of what was bought." *Barry Wright*, 724 F.2d at 236 (emphasis in original).

Indeed, each of the Supreme Court's decisions that underscored the necessity of using a price-cost test involved a claim of foreclosure, including claims of the ultimate sort of foreclosure – that a plaintiff has been put out of business. The Supreme Court's price-cost decisions involved claims (i) that defendants sought to drive plaintiffs "out of business," *Matsushita*¸ 475 U.S. at 584, (ii) that plaintiff would be driven out of the market by defendant's conduct, *Cargill*, 479 U.S. at 114, (iii) that defendant's conduct sought to impose painful losses on plaintiff by extending "discriminatory volume rebates directed at [plaintiff's] biggest wholesalers," *Brooke Group*, 509 U.S. at 231, (iv) that defendant's conduct "drove many independent gasoline dealers in California out of business," *Atl. Richfield*, 495 U.S. at 332, (v) that defendant "drove [plaintiff] out of business," *Weyerhaeuser*, 549 U.S. at 314-15, and (vi) that defendant "'squeeze[d]' the profit margins of its competitors" and thereby "raise[d] competitors' costs," *Linkline*, 129 S. Ct. at 1118. Of course, unlike the claimants in the Supreme Court's cases, AMD is not threatened with going out of business, as the company is getting its financial house in order following two years of exceedingly poor execution, and now has the financial might of Abu Dhabi investors behind its manufacturing operations.

Every Court of Appeals that has addressed the issue of discounts has held that they must be evaluated under a predatory pricing standard. In *Virgin Atlantic*, for example, the Second Circuit held that a plaintiff that alleged harm to competition from what it called "back-to-dollar-one" discounts must prove "(1) 'that the prices complained of are below an appropriate measure of its rival's [the defendant's] costs,' and (2) that the predatory rival has a 'dangerous probability' of recouping its investment through a below cost pricing scheme." 257 F.3d at 266 (quoting *Brooke Group*, 509 U.S. at 222-24). In *Concord Boat*, which involved a challenge to market share discounts, the Eighth Circuit similarly held, citing *Brooke Group* and *Matsushita*, that "above cost discounting is not anticompetitive." 207 F.3d at 1061. In *NicSand*, the Sixth Circuit ruled that an antitrust claim based on 3M's alleged payments to customers for exclusive distribution could not stand where the plaintiff "does not allege that 3M was selling below cost." 507 F.3d at 455. And in *PeaceHealth*, the Ninth Circuit stated "[i]n a single product case, we may simply ask whether the defendant has priced its product below its incremental cost of producing that product because a rival that produces the same product as efficiently as the defendant should be able to match any price." 515 F.3d at 903. No Court of Appeals has ever adopted a different position regarding single-product discounts.

There is simply no legal basis for attacking above-cost discounts on the basis that they disadvantage a competitor, make it harder for it to compete, raise its costs (by forcing it to match a discount), or cause it to lose sales that otherwise it might have won. All of these are normal consequences of price competition.

B. The Third Circuit Court of Appeals decision in *LePage's* Does Not Overrule Strict Application of the Price-Cost Test to Single-Product Pricing Practices

AMD relies principally on the Third Circuit's decision in *LePage's* to support its allegations that Intel's pricing practices violate the antitrust laws. *LePage's*, however, does not place AMD's allegations outside the realm of the price-cost test. *LePage's* involved a practice not at issue in this case, the systematic bundling of a series of distinct, unrelated products mainly through all-or-nothing rebates, which the Third Circuit viewed as not furthering competition on the merits. 324 F.3d at 155. 3M offered these discounts to customers that purchased six entirely different products, which included health care, home care, home improvement, stationery, retail auto, and leisure products. *Id.* at 154. In that limited context, the court found, citing the Areeda & Hovenkamp treatise, that 3M's rebates could foreclose an equally efficient competitor that did not offer the full panoply of 3M's bundled products. *Id.* at 155. The court specifically distinguished bundled rebates from "volume discounts," which it said are "concededly legal and often reflect cost savings." *Id*. at 154.

Notably, the Areeda & Hovenkamp treatise distinguishes above-cost single product discounts linked to volume or market share, which cannot exclude equally efficient competitors (3A Areeda & Hovenkamp, ¶ 749a at 310), from above-cost bundled discounts, which it states "can exclude an equally efficient rival who makes only one of the two products" in a hypothetical two-product bundle (*id.*, ¶ 749d at 328).

Any attempt to read *LePage's* as apply beyond bundling to single-product discounts cannot be reconciled with the Supreme Court's bright line cost-price test, which the Court recently reaffirmed in *Weyerhaeuser* and *Linkline*. *LePage's* had interpreted *Brooke Group* as having an exceedingly limited reach, stating that it "was primarily concerned with the Robinson-Patman Act, not § 2 of the Sherman Act" and that "nothing in the decision suggests that its discussion of the issue is applicable to a monopolist with its unconstrained market power." 324 F.3d at 151. The Supreme Court's subsequent decision in *Weyerhaeuser* made it indisputably clear, however, that the *Brooke Group* rule governs claims "under § 2 of the Sherman Act" (*Weyerhaeuser*, 549 U.S. at 319 n.1), and *Linkline* followed suit in applying *Brooke Group* to a section 2 claim without even commenting on its applicability.[1]

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[1] *See also Brooke Group*, 509 U.S. at 221-22 ("primary-line competitive injury under the Robinson-Patman Act is of the same general character as the injury inflicted by predatory pricing schemes actionable under § 2 of the Sherman Act. . . . Accordingly, whether the claim alleges predatory pricing under § 2 of the Sherman Act or primary-line price discrimination under the Robinson-Patman Act, two prerequisites to recovery remain the same. First, a plaintiff seeking to establish competitive injury resulting from a rival's low prices must prove that the prices complained of are below an appropriate measure of its rival's costs.").

Nor can there now be any doubt that even a company's "unconstrained market power" does not allow a plaintiff alleging antitrust claims grounded on pricing to avoid *Brooke Group*'s price-cost test. The claims in *Weyerhaeuser* involved the use of a "dominant position" to drive a competitor out of business, *id.* at 316, thus clearly implicating an alleged monopolist with unconstrained market power. *Linkline* involved a claim against a defendant that was alleged to control an "essential facility" and used its power to "preserve and maintain its monopoly control" (129 S. Ct. at 1115), again implicating the use of unconstrained market power. *Weyerhaeuser* and *Linkline* thus reaffirmed the Supreme Court's repeated holding that above-cost pricing cannot violate the antitrust laws, including section 2 of the Sherman Act.

Of course Supreme Court precedent trumps a lower court's decisions, but here it is not necessary to reach the question whether *Weyerhaeuser* and *Linkline* overruled *LePage's* for the simple reason that *LePage's* addressed bundled pricing and does not apply to single-product pricing.

C. Prices That Exceed Average Variable Cost Satisfy the Price Cost Test

Application of a price-cost test on any basis other than marginal cost, or its widely accepted surrogate average variable cost, would dilute the purpose behind the Supreme Court's bright-line standard by restraining the aggressive price competition the antitrust laws encourage. Nevertheless, it appears that AMD may take the position that the price-cost test may be satisfied by a test that is not confined to prices below incremental cost, or its widely adopted surrogate, average variable cost, on the products sold by a defendant. AMD has mentioned two possibilities: (1) looking at total costs (thus including all fixed and sunk costs) of the defendant, or (2) attributing all of the discounts provided in connection with a particular transaction to only some of the microprocessors sold in that transaction (a discount attribution test). The case law, however, has repeatedly rejected the use of total costs in applying the *Brooke Group* price-cost test, because it would defeat the reason for the test – encouraging profitable price cutting to ensure the maximum benefit for consumers.

As Justice Breyer has explained, "modern antitrust courts look to the relation of price to 'avoidable' or 'incremental' costs as a way of segregating price cuts that are 'suspect' from those that are not." *Barry Wright*, 724 F.2d at 232. The logic of this standard is that "[w]hen prices exceed incremental costs, one cannot argue that they must rise for the firm to stay in business. Nor will such prices have a tendency to exclude or eliminate equally efficient competitors. Moreover, a price *cut* that leaves prices above incremental costs was probably moving prices in the 'right' direction – towards the competitive norm." *Id.* (emphasis in original). *See also* Philip Areeda & Donald F. Turner, *Predatory Pricing and Related Practices Under Section 2 of the Sherman Act*, 88 Harv. L. Rev. 697, 711 (1975).

The marginal, or incremental, cost is "the cost of producing each incremental unit of output." *Advo, Inc. v. Philadelphia Newspapers, Inc.,* 51 F.3d 1191, 1198 (3d Cir. 1995). "As long as a firm's price[] exceeds its marginal cost, each additional sale decreases losses or increases profits." *Id*. Put differently, a sale at a price above marginal cost makes economic sense without regard to its impact on a competitor because it increases the firm's overall return on sales. As a result, pricing above marginal cost "is presumably not predatory." *Id.* Because of difficulties in measuring marginal cost directly, average variable cost is ordinarily used as a surrogate for marginal cost. *Advo*, 51 F.3d at 1198. Average variable cost is the standard adopted by most Courts of Appeals, and it is the standard that should apply in this case.

In addition to the Third Circuit, seven other Circuits that have decided this issue have accepted marginal cost, or its proxy, average variable cost, as the appropriate measure of cost. The following Courts of Appeals have adopted the average variable cost standard: (1) First

Circuit: *Tri-State Rubbish, Inc. v. Waste Mgmt., Inc.*, 998 F.2d 1073, 1080 (1st Cir. 1993); (2) Second Circuit: *Northeastern Tel. Co. v. AT&T*, 651 F.2d 76, 87-88 (2d Cir. 1981); (3) Third Circuit: *Advo*, 51 F.3d at 1198; (4) Fifth Circuit: *Stearns Airport Equip. Co. v. FMC Corp.*, 170 F.3d 518, 532 (5th Cir. 1999); (5) Seventh Circuit: *Schor v. Abbott Labs.*, 457 F.3d 608, 611 (7th Cir. 2006); (6) Eighth Circuit: *Concord Boat*, 207 F.3d at 1061 (8th Cir.); (7) Ninth Circuit: *PeaceHealth*, 515 F.3d at 909-10 & n.20 (9th Cir.); (8) Tenth Circuit: *United States v. AMR Corp.*, 335 F.3d 1109, 1115-16 (10th Cir. 2003).[2]

1. A Total Cost Price-Cost Test Would Defeat The Supreme Court's Bright-Line Standard By Inhibiting Aggressive Price Competition

Any argument that the microprocessor industry should be governed by a special standard that includes fixed and sunk capital costs also fails. Such a test would force Intel to forego profitable sales of additional units because the microprocessor industry has high and continuing research and developments costs and low next unit manufacturing costs. Any argument that an industry-specific standard should be carved out in this case has no basis in law or economics. Indeed, the low "next unit" cost that characterizes the microprocessor industry is precisely why it makes economic sense to compete for additional sales by providing lower prices. It is more profitable to sell additional microprocessors at a price above the low cost of producing the product than to let capacity sit idle and lose the revenues from the sales lost as a result.[3] As the

[2] In addition, the DC Circuit has expressed "serious doubts about the usefulness of FDC [fully distributed cost] as a measure of cost to be used in distinguishing lawful from predatory pricing." *Southern Pac. Commc'ns Co. v. AT&T*, 740 F.2d 980, 1006 (D.C. Cir. 1984).

[3] In addition, any total cost standard is neither tractable nor meaningful. "[A]ll multiproduct firms have fixed costs incurred in common on behalf of two or more of their products. There is, however, no economically defensible way of dividing such costs up among the firm's various products. As is well known, all methods for the allocation of common fixed costs are arbitrary." William J. Baumol, *Predation and the Logic of the Average Variable Cost Test*, 39 J.L. & Econ.

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leading antitrust treatise emphasizes, "marginal-cost pricing leads to a proper resource allocation and is consistent with competition on the merits, and the exceptions are too factually ambiguous to permit reliable judicial recognition." 3A Areeda & Hovenkamp, ¶ 739c at 182.

Any deviation from the AVC approach on an industry-specific basis would rob the law of the very predictability that the Supreme Court has repeatedly engraved as a core value of the antitrust law governing pricing. *See Brooke Group*, 509 U.S. at 222; *Matsushita*, 475 U.S. at 594. As the Supreme Court reminded us again in early 2009 in *Linkline*, "[w]e have repeatedly emphasized the importance of clear rules in antitrust law." 129 S. Ct. at 1120-21. The Court emphasized the importance of offering a "safe harbor for [] pricing practices" and that a rule that deprived firms of a safe harbor would be "most troubling." *Id*. at 1121. *See also Town of Concord v. Boston Edison Co*., 915 F.2d 17, 22 (1st Cir. 1990) (Breyer, J.). As two leading economic experts have observed regarding previous attempts to avoid a clear and predictable price-cost test, "obscurity and ambiguity are convenient tools for those enterprises on the prowl for opportunities to hobble competition." William J. Baumol & Janusz A. Ordover, *Use of Antitrust to Subvert Competition*, 28 J.L. & Econ. 247, 254 (1985).

To prove that Intel priced below cost, AMD must show that Intel's discounts, when applied to the total number of units purchased in a transaction, resulted in price levels below average variable cost. As shown above, single-product discounting, including discounts that are linked to volume or share targets, are subject to the ordinary predatory pricing standard. This means that proper application of the price-cost test requires comparing the expected revenues

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49, 59 (1996). Accordingly, average total cost is "always manipulated to produce whatever answers are desired by the party that puts them forward." Id.

from the sales covered by an agreement with the average variable cost of producing the microprocessor units covered by the agreement.

2. A Discount Attribution Test Would Emasculate the Supreme Court's Bright-Line Price-Cost Test by Discouraging Aggressive Price Competition

AMD argues that Intel's sales of a single product – microprocessors – should be treated as the sales of two separate products, on the theory that the quantity of microprocessors an OEM wants to buy can be divided into two categories – "contestable" and "non-contestable" quantities. AMD then argues that a discount attribution test should be applied to evaluate whether Intel satisfies the price-cost test. AMD would attribute any discounts Intel provides an OEM to sell "non-contestable" quantities should be added to the discounts Intel provides for the "contestable" quantities.

This manipulation of the cost-price test cannot be justified under the principles that the Supreme Court has enunciated repeatedly. Such an approach would modify the Supreme Court's rigorous price-cost test by providing that, where a weaker competitor cannot compete for all of a customer's business, its more successful competitor must somehow determine how much of the customer's business its rival can capture, and ensure that its overall discounts, while above-cost, do not give it some sort of "unfair" advantage on that portion of the demand. In other words, the discount attribution test would turn otherwise legal above-cost pricing into anticompetitive conduct based on a competitor's lack of capabilities, and turn the price-cost test into a guessing game that requires a firm to base its pricing decisions on highly uncertain assumptions concerning how much of a customer's business a rival can take. But "[a]ntitrust begins with the premise that all firms, even dominant firms, are permitted to compete aggressively, and that hard competition is a desideratum rather than an evil." 3A Areeda & Hovenkamp ¶ 735A at 127.

Nor can the application of a discount attribution test be justified by analogizing Intel's sales of a single product, microprocessors, to a bundle of two separate products. Unlike bundling cases such as *LePage's,* here the two allegedly separate products happen to be the same – microprocessors and microprocessors. AMD attempts to get around this inconvenient fact by claiming that a microprocessor in fact is two separate products because microprocessor demand can be divided into two groups, contestable and uncontestable. Under this perverse logic, it is possible for Intel to bundle the same product with itself, by bundling contestable microprocessor demand with uncontestable microprocessor demand. This sleight of hand cannot conceal the fact that a sale of microprocessors is a sale of a single product, and that the sale of microprocessors is not analogous to – let alone constitutes – a sale of a bundle of discrete products. A microprocessor by any other name is still a microprocessor.

There is no logical way to bring this case within the rubric of *LePage's* and its predecessor, *SmithKline Corp. v. Eli Lilly & Co.*, 575 F.2d 1056 (3d Cir. 1978), the leading Third Circuit cases on bundled discounts. Both of those cases concerned discounts granted on the purchase of bundles of entirely different products. They did not concern and have no relevance to single-product discounts. As *LePage's* explained *Eli Lilly*, "the gravamen of Lilly's § 2 violation was that Lilly linked a product on which it faced competition with products on which it faced no competition." 324 F.3d at 156. In *Eli Lilly*, Lilly linked patented products, for which competition was not possible, to non-patented products. And in *LePage's*, 3M bundled a series of highly diverse products that the plaintiff did not manufacture with the product over which 3M had monopoly power (transparent tape), which the plaintiff also supplied. In this case, no such bundling of different products is present. Both Intel and AMD offer a full range of microprocessor types and performance characteristics.

In *Concord Boat*, the Eighth Circuit made it clear that bundling case law has no relevance to cases involving single-product discounts. Referring to tying and bundling cases cited by the plaintiffs, the court stated: "Because only one product, stern drive engines, is at issue here and there are no allegations of tying or bundling with another product, we do not find these cases persuasive." 207 F.3d at 1062. The Ninth Circuit in *PeaceHealth* also distinguished bundling cases from single-product discount cases, emphasizing "in single product pricing cases, the Supreme Court has not adopted rules condemning prices above a seller's incremental costs." 515 F.3d at 904. The court said that "bundled discounts present one potential threat to consumer welfare that single product discounts do not," which is the exclusion of an equally efficient single-product competitor, even where the bundle is sold above cost. *Id.* *PeaceHealth* offers no support for a discount attribution test here, as it expressly states that single-product discounts are subject to the ordinary predatory pricing standard. *Id.* at 903.

PeaceHealth recognized that the above-cost safe harbor rule for single-product discounts reflects a "cost-benefit rejection of a more nuanced rule" based on the risk that rules that lack the clarity and predictability of a price-cost test based applied to the total units sold would deter procompetitive discounting. *Id*. at 904. The leading antitrust treatise observes that "the same concerns about management of complexity and the danger of overdeterrence, or 'false positives'" that led to the adoption of a simple price-cost test for predatory pricing apply in the discounting area as well. 3A Areeda & Hovenkamp, ¶ 749a at 306. For this reason, the treatise recognizes that single-product discounts should be subject to the ordinary predatory pricing rules, under which the after-discount price is lawful if it exceeds the defendant's average variable cost. *Id*. at 309-10; 3B Areeda & Hovenkamp ¶ 768b at 169. By contrast, both *PeaceHealth* and the treatise support the application of a discount attribution test to bundled discounts of disparate products. Under this test, the price of a bundle that incorporates both a monopoly product and an entirely different but competitive product is lawful if the price of the competitive product, after attribution of the entire discount to that product, is above average variable cost. *PeaceHealth*, 515 F.3d at 906-08; 3A Areeda & Hovenkamp, ¶ 749d at 323.

The reported bundled discount cases have been characterized by the existence of price schedules that assign discrete prices to each bundle component when sold separately and a price for the entire bundle. In such circumstances, "[t]he discount attribution standard provides clear guidance for sellers that engage in bundled discounting practices. A seller can easily ascertain its own prices and costs of production and calculate whether its discounting practices run afoul of the [attribution] rule . . . ." *PeaceHealth*, 515 F.3d at 907.

By contrast, an attribution test would place companies in an untenable position of making real-time decisions in the heat of competition while facing great uncertainty regarding the key parameters on which application of the test depends. Based on incomplete information, companies would have to (i) divide up demand for a single product into the uncontestable and contestable categories, (ii) assign a but-for price to the "uncontestable" portion of the demand, for which there is no separate price schedule that assigns a price for that portion of the demand, (iii) attribute the incremental discount for buying both the uncontestable and contestable units to the latter (even though the but-for price would have been the subject of negotiations based on different purchase volume assumptions), and (iv) calculate an attributed price for the contestable portion of the demand.[4] *See* 3B Areeda & Hovenkamp ¶ 768b at 169 n. 41 (criticizing

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[4] There is no basis for assuming that Intel would not have provided substantial discounts to an OEM even if Intel had lost the so-called contestable portion of the business. Indeed, when Intel lost business to AMD, it continued to provide discounts to its customers to meet competition

[Footnote continued on next page]

"contestable share" approach for "requir[ing] a jury to determine such things as the minimum market share that a reseller must sell of the defendant's product in order to remain viable"). Even if such a test could be applied years after the fact with the benefit of 20-20 hindsight and extensive discovery, it cannot be applied by companies in the real time in which they must negotiate sales transactions.

As a result, any attempt to fashion a rule that would artificially divide a company's sales of a single product into contestable and uncontestable sales, and to attribute all or a portion of Intel's overall discounts to the contestable sales only, is irreconcilable with the Supreme Court's insistence on a bright line principle that firms can implement in the ordinary course of business. *See Matsushita*, 475 U.S. at 594; *see also Barry Wright*, 724 F.2d at 234. A test of this sort would expose a firm to potentially ruinous treble-damage liability for aggressive pricing based on factors that they cannot predict with confidence in the heat of competition, and thus would unacceptably "'chill the very conduct the antitrust laws are designed to protect,'" *Weyerhaeuser*, 549 U.S. at 320 (quoting *Brooke Group*, 509 U.S. at 226).

In addition, any argument that Intel "bundles" its "contestable" and "uncontestable" microprocessors hinges on the claim that at any given time, a particular OEM must obtain most of its microprocessor requirements from Intel. This concept is both factually incorrect and irrelevant.

[Footnote continued from previous page]
from AMD. Intel has every incentive to discount what AMD would apparently label as the "uncontestable" volume to retain as much of the OEM's business as possible, and to ensure that the OEM's systems incorporating Intel microprocessors will be competitive against AMD-based systems in the downstream market.

The argument is factually incorrect because OEMs have the ability to purchase, and do purchase when it makes business sense, a significant share of their needs from AMD and make rapid shifts of purchases to AMD. The fact that OEMs purchase more from Intel does not mean that they cannot buy from AMD but only that they prefer to buy from Intel more often than they prefer to buy from AMD. Indeed, in its Pretrial Statement AMD attempts to justify its attempts to hobble Intel's freedom to compete by stating that it is disadvantaged by "end-user demand that is microprocessor specific," a blunt admission that end users prefer Intel over AMD. This preference is the consequence of consumer choice – the value that AMD claims to be advancing but in fact seeks to restrain through its antitrust claims.

AMD's bundling argument is also irrelevant because the Supreme Court's jurisprudence does not countenance the application of a different, highly unpredictable price-cost test against companies simply because they are successful. The fact that customers prefer Intel over AMD does not support imposing on Intel a different test. Likewise, the fact that Intel has made the investment to position itself to supply all the needs of a customer, and AMD has failed to do so, does not justify imposition of a discount attribution test. "[E]ven with monopoly power, a business entity is not guilty of predatory conduct through excluding its competitors from the market when it is simply exploiting competitive advantages legitimately available to it." *Virgin Atl.*, 257 F.3d at 266.

At the end, the "contestability" claim is no more than a damning concession that end customers prefer Intel. But whatever its purpose, this claim cannot serve as a basis for changing the Supreme Court's unwavering price-cost standard. As the Supreme Court stated with words that apply with equal force to the proposed claims against Intel, "[i]t would be ironic indeed if the standards for predatory pricing liability were so low that antitrust suits themselves became a tool for keeping prices high." *Brooke Group*, 509 U.S. at 226-27.

Notwithstanding the foregoing, Intel is confident that its discounts easily pass the discount attribution test. Although the numerous difficulties and uncertainties of a cost attribution test are manifest, here it is possible to resolve the uncertainties by making conservative assumptions unfavorable to Intel in applying the test. Even under such assumptions, Intel's prices invariably remain comfortably above cost. One important reason for this outcome is that Intel has consistently produced microprocessors more efficiently than AMD through its deployment of more advanced manufacturing processes. Intel has led AMD by as much as a year in deploying new generations of manufacturing technology, which enabled it to produce twice as many transistors as AMD on a microprocessor die of the same size. In addition, Intel led AMD by four years in the deployment of the larger 300-mm wafers, which reduced manufacturing costs by approximately 25-30% relative to the 200-mm wafers that AMD was using. With significant cost advantages resulting from superior manufacturing technologies, Intel has had a comfortable margin between price and cost. Nevertheless, the critical point remains that the discount attribution test is contrary to controlling Supreme Court authority, and should not be applied under any circumstance.

III. DISCOUNTING TO WIN MORE BUSINESS IS NOT EXCLUSIVE DEALING

The price-cost test cannot be avoided by calling Intel's conduct exclusive dealing. As shown above, the Supreme Court has emphasized that the price-cost test applies to all pricing regardless of the type of antitrust claim asserted. Resort to the "exclusive dealing" label to describe Intel's conduct is both factually incorrect and unavailing. Indeed, both the Sixth Circuit in *NicSand* and the Eighth Circuit in *Concord Boat* determined that the price-cost test applies to claims of "exclusive dealing" (*NicSand*, 507 F.3d at 467) or "de facto exclusive dealing" (*Concord Boat*, 207 F.3d at 1054), where the alleged exclusivity was achieved through favorable pricing terms or market share discounts. In *NicSand*, the plaintiff's claim that 3M "eliminat[ed] its only competitor through a series of exclusive dealing contracts" (507 F.3d at 467) did not escape the price-cost test because the exclusivity, although the subject of agreements with 3M's customers, was achieved through price concessions.

None of Intel's conduct AMD challenges involved a traditional exclusive dealing arrangement. "In its simplest form, an exclusive dealing arrangement is a contract between a manufacturer and a buyer that forbids the buyer from purchasing the contracted good from any other seller or that requires the buyer to take all of its needs in the contracted good from that manufacturer." XI Areeda & Hovenkamp, ¶ 1800a at 3. Under such an agreement, a "buyer can purchase the good subject to the exclusive agreement only by breaching its contract or else by giving up something in which it has made a significant investment." Areeda & Hovenkamp, ¶ 1807 at 418 (2007 Supp). Where exclusive dealing violates the law, its vice is that "an equally efficient producer of the excluded product cannot steal the sale simply by offering a somewhat lower price." *Id*. For example, if a distributor must carry a supplier's goods in order to stay in business, a requirement that it buy only from that supplier would exclude an equally efficient competitor. By contrast, a requirement that a distributor sell more of a supplier's goods to receive a lower price cannot exclude an equally efficient competitor because such a rival can match the low price offer. 3A Areeda & Hovenkamp, ¶ 749a at 309-10.

The all-or-nothing choice at issue in *United States v. Dentsply Int'l, Inc.,* 399 F.3d 181 (3d Cir. 2005), typifies exclusive dealing agreements that may raise competitive concerns. In *Dentsply*, a monopoly supplier adopted an official policy under which it threatened to stop doing business with distributors that sold its competitors' products. The evidence showed that the distributors stopped doing business with the rivals for "fear of losing the right to sell" Dentsply's products to their own customers. *Id.* at 195. By imposing this "all-or-nothing choice" (*id.* at 196), Dentsply was able to impose "aggressive price increases" to the detriment of consumers (*id.* at 190); "experts for *both* parties testified that . . . prices would fall" if Dentsply stopped refusing to do business with customers that bought from other suppliers. *Id.* at 190-91 (emphasis added).[5]

By contrast, achieving a sole source position with a buyer through discounting is not exclusive dealing. As the Ninth Circuit put it in *Western Parcel Express v. United Parcel Serv. of Am., Inc.,* 190 F.3d 974, 976 (9th Cir. 1999), "contracts [that] do not preclude consumers from using other [suppliers] . . . are not exclusive dealing contracts that preclude competition in violation of the Sherman Antitrust Act." Without proof of the anticompetitive nature of the pricing used to obtain the sale, *i.e*., below-cost pricing, condemning Intel for having high shares of the purchases of OEMs would be akin to finding liability based on market share alone. *See Concord Boat*, 207 F.3d at 1062-63 ("Brunswick's discount programs were not exclusive dealing contracts and its customers were not required either to purchase 100% from Brunswick or to refrain from purchasing from competitors in order to receive the discount"). Exclusive dealing principles do not apply when the buyer is *not* locked into a long-term exclusivity contract and is free to shift purchases to a rival within a reasonable period.

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[5] The Court also noted that "[t]his case does not involve a dynamic, volatile market like that in *Microsoft*, [253 F.3d 34, 70 (D.C. Cir. 2001)]," and suggested that the result might have been different if it had involved such a market. 399 F.3d at 196. The microprocessor market *is* precisely such a market.

Here the claim is not of a refusal to supply customers that buy from AMD but of offering a lower, but above-cost, price to win more of the customers' business. AMD characterized this claim as *de facto* exclusive dealing. Even if such a claim could avoid a price-cost test where exclusivity is actually attained – and we have shown that it cannot where the mechanism for achieving increased sales is a lower price – in the case of all of the major OEMs but one, there cannot even be a claim of *de facto* exclusivity. They all bought microprocessors from AMD, and at varying times, each bought considerable volumes from AMD. And while Dell sourced solely from Intel until 2006, Dell was never required to buy exclusively from Intel and never believed it was so obligated – a point that Dell's CEO Michael Dell has affirmed publicly. Dell had many valid independent reasons for sourcing solely from Intel before it started buying AMD microprocessors in 2006.

Moreover, even though Intel's agreements cannot be characterized as exclusive dealing agreements, there is a broad consensus in the courts that even complete "exclusivity" agreements that have a relatively short duration or are easily terminable are presumptively lawful. *See CDC Techs., Inc. v. IDEXX Labs., Inc*., 186 F.3d 74, 80-81 (2d Cir. 1999) (exclusive dealing not unlawful where contracts were easily terminable on short notice); *Omega Env'l, Inc. v. Gilbarco, Inc*., 127 F.3d 1157, 1163-64 (9th Cir. 1997) (one-year agreements terminable upon 60-day notice are lawful); *U.S. Healthcare, Inc. v. Healthsource, Inc*., 986 F.2d 589, 596 (1st Cir. 1993) (exclusivity agreement terminable upon 30-notice is lawful); *Roland Machinery Co. v. Dresser Indus., Inc*., 749 F.2d 380, 395 (7th Cir.1984) ("[e]xclusive-dealing contracts terminable in less than a year are presumptively lawful"); *Stitt Spark Plug Co. v. Champion Spark Plug Co.*, 840 F.2d 1253, 1258 n.18 (5th Cir. 1988) (citing *Roland Machinery* with approval); *see also Balaklaw v. Lovell*, 14 F.3d 793, 799 (2d Cir. 1994) (noting that exclusive dealing arrangements with reasonable termination provisions "may actually encourage, rather than discourage, competition").[6] None of the arrangements challenged by AMD involve an agreement of a sufficient duration to give rise to competitive concerns, even if such agreements could be analyzed outside the framework of the price-cost test.

In short, Intel did not enter into any exclusive dealing agreements and did not even have a sole source supplier relationship with two of the three major OEMs that are the focus of AMD's accusations. Thus, wholly apart from the Supreme Court's pricing jurisprudence, Intel's discounting agreements cannot be characterized as exclusive dealing agreements. And both *NicSand* and *Concord Boat* confirm what six Supreme Court decisions have repeatedly underscored – labeling a discount arrangement linked to market share as exclusive dealing does not obviate the necessity to show that the defendant priced below cost.

IV. THE PRICE-COST TEST CANNOT BE CIRCUMVENTED BY RESORT TO A "MONOPOLY BROTH" THEORY

AMD hopes to sidestep the Supreme Court's bright line price-cost test by its argument that there is no need to show that specific conduct by Intel is anticompetitive but only that the combined effect of each type of conduct, although individually lawful, nevertheless renders the overall result unlawful. As shown above, however, the Supreme Court's jurisprudence requires the application of the price-cost test specifically to *every* challenge to pricing conduct. Moreover, the Court's recent *Linkline* decision confirms, as the Courts of Appeals have done

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[6] In *United States v. Dentsply Int'l*, 399 F.3d 181, 194 (3d Cir. 2005), the Third Circuit acknowledged this uniform body of precedent, *id.* at 194 n.2, but found it inapplicable on the facts of that case, where the defendant had engaged in an outright refusal to deal with customers that did business with its rivals. As noted above, unlike the case with above-cost discounts, an equally efficient competitor cannot counter such refusal where distributors must carry the seller's products.

before it, that a violation cannot be established by combining individual practices that are not themselves independently unlawful. In *Linkline*, the Court held that plaintiffs may not "join a wholesale claim that cannot succeed with a retail claim that cannot succeed, and alchemize them into a new form of antitrust liability never before recognized by this Court. We decline the invitation to recognize such claims. Two wrong claims do not make one that is right." 129 S. Ct. at 1123.

Even before *Linkline*, courts "reject[ed] the notion that if there is a fraction of validity to each of the basic claims and the sum of the fraction is one or more, the plaintiffs have proved a violation of . . . section 2 of the Sherman Act." *City of Groton v. Conn. Light & Power Co*., 662 F.2d 921, 928-29 (2d Cir. 1981). Even where the challenged acts are interrelated, the court must "analyze the various issues individually." *Id*. at 928; *see also Intergraph Corp. v. Intel Corp*., 195 F.3d 1346, 1367 (Fed. Cir. 1999) ("Each legal theory must be examined for its sufficiency and applicability, on the entirety of the relevant facts"); *Invacare Corp. v. Respironics, Inc*., 2006 WL 3022968 at *8 (N.D. Ohio, Oct. 23, 2006) ("The court rejects Plaintiff's contention that a court should view Defendant's conduct 'as a whole' rather than examine specific anticompetitive conduct"); *Southern Pac. Commc'ns v. AT&T Co*., 556 F. Supp. 825, 889 n.69 (D.D.C. 1983) ("[O]nce a claim is found to be without merit, such a claim cannot be used as a basis for finding other claims to constitute a violation of the antitrust laws"). Above-cost price competition, which is unassailable under the antitrust laws, cannot morph into market-wide illegal exclusion through claimed "synergies" of claims.

V. CONCLUSION

Controlling Supreme Court authority compels analyzing Intel's pricing-related conduct through the lens of a bright line price-cost test. No amount of recharacterization of the conduct can avoid this outcome. The Supreme Court has made it clear that pricing conduct can only result in an antitrust violation if a defendant prices below cost, regardless of the type of antitrust claim asserted. The decisions of the Courts of Appeals also make it clear that the price-cost test is the only vehicle for evaluating claims of exclusivity or near exclusivity that are based on pricing incentives, regardless of whether the plaintiff characterizes them as market share discounts, “back-to-dollar-one” discounts, or even exclusive dealing agreements.

AMD chose to file this lawsuit notwithstanding this clear body of antitrust law encouraging aggressive above-cost price cutting – to try to intimidate Intel into competing with less fervor, to make it easier for AMD to win business without competing as hard. That's not resorting to the antitrust laws to protect the competitive process. - That's perverting the antitrust laws to protect a less successful competitor. Consumers would be the losers if AMD succeeds.

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