



Meet the expert

Competition

CRA Charles River
Associates

May 2011



Robert J. Levinson

Robert J. Levinson specializes in industrial organization and antitrust analysis and has particular expertise in the economics of the computer software and hardware industries. He has worked on a wide variety of mergers and non-merger competition matters in the US and abroad. Before entering private practice, Dr. Levinson served as an economist on the staff of the Federal Trade Commission and as the personal Economic Advisor to FTC Commissioner Deborah K. Owen.

Why do the computer hardware and software industries attract so much antitrust scrutiny?

There are many reasons, including the potential for network effects, inter-temporal leverage, and abuse of the standardization process. When technologies are proprietary and compatibility is important to consumers, network effects can potentially lead to the rise of dominant suppliers protected by significant barriers to entry in the form of high switching costs for consumers. Such entrenched suppliers may be able to leverage their market power today to forestall the rise of competing technologies tomorrow (as illustrated by the *Microsoft* cases in the US and Europe). Another concern associated with switching costs can arise because of the computer industry's tendency to rely upon voluntary standards comprised of multiple technologies. This creates the prospect that individual IP owners may engage in opportunistic pricing behavior once the standard is adopted and the industry has sunk investments in producing standards-based products (as alleged, for example, in the *Rambus* and *Qualcomm* cases).

Do the new DOJ/FTC Horizontal Merger Guidelines signal an increased concern with the potential for anticompetitive mergers in high-technology industries?

The initial draft of the new Guidelines suggested that mergers in industries characterized by high margins were likely to raise competitive concerns. Microprocessors and software are produced at low marginal costs but often command high gross margins. As issued, the Guidelines recognize that high margins might be necessary if developers are to recoup their up-front investments. Under such circumstances high (short-run) margins may be consistent with long-run competitive prices—that is, prices that are sufficient only to allow market participants to cover their long-run costs.

Will the agencies' new UPP approach affect the review of high-technology mergers?

Technology mergers typically combine sellers of imperfect substitutes. The agencies' recent introduction of upward pricing pressure (UPP) analysis can suggest that mergers of sellers of substitute products—even when they are not “closest substitutes” as measured in terms of cross-price elasticities or diversion ratios—may create incentives to raise price and thus could pose competitive concerns. If

the agency does apply a UPP analysis, such concerns can be addressed using more realistic competitive effects analyses that take into account factors that are assumed away in the baseline UPP model. These factors include the possibility of innovation competition or other forms of non-price rivalry, the existence of capacity constraints, the potential for merger-specific improvements in product quality, or dynamic rather than static profit maximization on the part of industry participants.

How often do intellectual property issues factor into the antitrust analysis of high-technology cases?

Antitrust cases in the high-technology area almost always involve intellectual property issues. While the most obvious example is the use of antitrust counterclaims to respond to intellectual property lawsuits, the connection between IP rights and competition concerns in high-technology industries runs deeper. One way to secure market power in a downstream market is to corner the market for an “essential” input, which, in the technology space, means almost always intellectual properties as protected by patents or trade secrecy.

There is nothing inherently wrong with unique factor ownership or the ability of a technology owner to benefit from such rights. Economists generally agree that the inventor of an essential technology for cellular telephones should not be stopped from earning rents from it. However, it is sometimes possible for holders of “essential” patents to go too far. Technology owners may, unilaterally or in concert with holders of other essential technologies, act to deter the development or block the acceptance of alternative technologies. Or they may attempt to extend their market positions by withholding interoperability information to suppliers of complementary products in the hope of gaining share in markets for complements. Or they may merge with developers of substitutes for their technologies in order to eliminate actual or potential competition. Whether such allegations have merit is, of course, a matter of factual inquiry and economic analysis, which must be conducted on a case-by-case basis.

For more information, please contact:

Robert J. Levinson

Vice President

Washington, DC

+1-202-662-3881

RLevinson@crai.com

www.crai.com/antitrust



The conclusions set forth herein are based on independent research and publicly available material. The views expressed herein do not purport to reflect or represent the views of Charles River Associates or any of the organizations with which the authors are affiliated. The authors and Charles River Associates accept no duty of care or liability of any kind whatsoever to any party, and no responsibility for damages, if any, suffered by any party as a result of decisions made, or not made, or actions taken, or not taken, based on this paper. If you have questions or require further information regarding this issue of *Meet the Expert*, please contact the contributor or editor at Charles River Associates. This material may be considered advertising. Detailed information about Charles River Associates, a registered trade name of CRA International, Inc., is available at www.crai.com.

Copyright 2011 Charles River Associates