CPI COMPETITION POLICY INTERNATIONAL

CPI Antitrust Chronicle
Dec 2014 (1)

# The Broader Implications of Merger Remedies in High Technology Markets

D. Daniel Sokol
University of Florida

# The Broader Implications of Merger Remedies in High Technology Markets

D. Daniel Sokol[1]

## I. INTRODUCTION

Merger remedies are an area of increasing complexity around the world. They are also an area of increased focus by competition authorities both with regard to process (particularly coordination) and substance. The recent ICN merger working group workshop held in New Delhi, India focused on the question of merger remedies across jurisdictions.

Mergers in high technology (high tech) markets remain an area in which there seems to be unsettled law and policy in a number of jurisdictions and where remedies for the same behavior may lead to different outcomes. This essay examines what makes high tech mergers distinct relative to other mergers. It then examines the distinctive remedies (or lack thereof) that agencies may undertake to address competitive concerns in high tech markets. A number of cases suggest that competition authorities should undertake a more nuanced view of how high tech markets work in their merger remedies and, by implication, dominance cases—especially considering the dynamics of the particular case before them.

## II. WHY MERGER CONTROL GENERALLY

Merger control seeks to weigh the potential pro-competitive impact of a merger, such as through price reductions or increased quality, against potential anticompetitive effects. The danger of a particular merger is that the merged firm will exercise market power that it did not possess pre-merger or will allow a firm with market power to enhance its market power post-merger and reduce consumer welfare.

## III. MERGER CONTROL IN TECHNOLOGY MARKETS

In the high-tech setting, agencies must be particularly careful to analyze the market and the facts to ensure that merger control does not reduce the incentives of firms to innovate or chill investment decisions that would lead to enhanced innovation.[2] Merger control potentially collides with technological innovation because of certain characteristics of high tech markets. These markets are ones in which there is rapid technological change and innovation. The innovation can be in new products, services, and/or platforms.

---

[1] Professor of Law, University of Florida.

[2] Thomas Cotter summarizes the potential trade off as "The obvious problem, once we accept the principle that any conduct that threatens some harm to innovation or creativity (no matter how speculative) properly could give rise to antitrust liability, is knowing where to stop." Thomas F. Cotter, *Innovation and Antitrust Policy, in* THE OXFORD HANDBOOK OF INTERNATIONAL ANTITRUST ECONOMICS, VOLUME 2 147 (Roger D. Blair & D. Daniel Sokol eds. 2014). Similarly, Carl Shapiro provides a roadmap for undertaking this analysis through the lenses of contestability, appropriability, and synergies; Carl Shapiro, *Competition and Innovation: Did Arrow Hit the Bull's Eye?*, *in* THE RATE AND DIRECTION OF INVENTIVE ACTIVITY REVISITED (Josh Lerner & Scott Stern eds. 2012).

As high tech markets change rapidly, market power may be transient.[3] The idea of the ephemeral nature of market power has its origins in Schumpeter's views on creative destruction.[4] Due to the nature of technological change, firms compete for a market through innovation and other strategies that are highly disruptive to existing markets. This is competition *for* the market rather than competition *in* the market. In these circumstances, prediction is more complex and difficult. Should there be no clear theory of harm and no facts to support such a determination, aggressive intervention risks chilling procompetitive innovation. In some cases the best remedy may be no remedy. This has been the case across the United States, Europe, and other leading jurisdictions in a number of transactions.

### A. Network Effects May be Different in Technology Markets

In many high tech markets, network effects play an important role.[5] Oftentimes these effects arise because of complementarities, where a user can reach additional users the more users that are on the network (such as mobile telephony). Although network effects may be particularly strong in old economy networks, new economy networks may behave differently. Network effects may not exist in all high tech markets. The internet may be one such example.[6] However, it is not the only one.

One case in which the network effects were found to be insubstantial was in *Microsoft/Skype*. In that merger, the Commission cleared the merger in phase I between a conglomerate firm (Microsoft) and Skype, a firm that "provided internet-based communications services and software enabling instant messaging and voice and video communications."[7] The General Court upheld the Commission's decision because network effects proved not to matter due to the dynamics of the industry—short innovation cycles and free products. The General Court noted, "the existence of network effects does not necessarily procure a competitive advantage for the new entity."[8]

---

[3] Renata B. Hesse, Deputy Assistant Att'y Gen. for Criminal & Civil Operations, U.S. Dep't of Justice, Remarks as Prepared for the Conference on Competition & IP Policy in High-Tech. Indus.: At the Intersection of Antitrust & High-Tech: Opportunities for Constructive Engagement, (Jan. 22, 2014), http://www.justice.gov/atr/public/speeches/303152.pdf.

[4] JOSEPH A. SCHUMPETER, CAPITALISM, SOCIALISM AND DEMOCRACY 83 (3d ed. 1950). *See* also Jonathan B. Baker, *Beyond Schumpeter vs. Arrow: How Antitrust Fosters Innovation*, 74 ANTITRUST L.J. 575, 587 (2007); ("As a general rule, competition does not just lead firms to produce more and charge less; it encourages them to innovate as well.").

[5] *See* generally Daniel F. Spulber & Christopher S. Yoo, *Antitrust and the Economics of Networks*, *in* THE OXFORD HANDBOOK OF INTERNATIONAL ANTITRUST ECONOMICS, VOLUME 1 (Roger D. Blair & D. Daniel Sokol eds. 2014).

[6] *Id.* at 385 ("Because the Internet is a network of networks, it is often said to exhibit network economic effects, although upon closer inspection the constantly increasing returns to scale may be limited to specific networks, such as social networks, rather than the Internet itself.").

[7] General Court Press Release, No 156/13, Luxembourg, 11 December 2013, Judgment in Case T-79/12, Cisco Systems Inc. and Messagenet SpA v Commission, *available at* http://curia.europa.eu/jcms/upload/docs/application/pdf/2013-12/cp130156en.pdf.

[8] Judgment in Case T-79/12, Cisco Systems Inc. and Messagenet SpA v Commission, 11 December 2013 at ¶76, *available at* http://curia.europa.eu/juris/liste.jsf?num=T-79/12.

The Commission's thoughts regarding network effects not necessarily conferring an advantage also came up in the recent *Facebook/WhatsApp* clearance. In that clearance, the Commission explained that that "while network effects exist in the market for [messaging] apps, in the present case, on balance, they are unlikely to shield the merged entity from competition from new and existing consumer communications apps."[9] The rationale for this was due to:

1. the Commission finding that messaging apps were a "fast-moving sector"[10] with low switching costs; therefore, "any leading market position even if assisted by network effects is unlikely to be incontestable.";[11]
2. the usage of one particular messaging app did not "exclude the use of competing [messaging] apps by the same user;" in this context, multi-homing was common and facilitated by the "ease of downloading a consumer communications app."[12]; and
3. the users of messaging apps "are not locked-in" to a given network.[13]

### *B. Market Definition is Not Always Clear and Even When It Is, High Market Shares are not Fatal*

Traditionally, antitrust considers market power to be a basis for potential antitrust liability in the merger context.[14] Consequently, market definition remains a key way that authorities around the world undertake a market power inquiry.[15] Yet, in some high tech markets, market definition is not always clear. Indeed, traditional measures like market share may not be appropriate measurements in analyzing a given market.

Returning to the example of *Microsoft/Skype*, the General Court found that switching costs were low, explaining that "the network effects to which the concentration might give rise would be diluted by the fact that users tend to communicate in small restricted circles and use a range of operators."[16] Those factors demonstrated the ease with which user groups could switch to other communications services even though the General Court acknowledged a market share of over 90 percent.[17]

---

[9] Case COMP/M.7217, *Facebook/WhatsApp*, at ¶135.

[10] *Id.* at ¶132

[11] *Id.*

[12] *Id.* at ¶133.

[13] *Id.* at ¶134.

[14] Lawrence J. White, *Monopoly and Dominant Firms: Antitrust Economics and Policy Approaches, in* THE OXFORD HANDBOOK OF INTERNATIONAL ANTITRUST ECONOMICS, VOLUME 1 (Roger D. Blair & D. Daniel Sokol eds. 2014).

[15] *See* e.g., U.S. Dep't of Justice & Fed. Trade Comm'n, Horizontal Merger Guidelines (2010) § 4, *available at* http://www.justice.gov/atr/public/guide lines/hmg-2010.pdf ("The measurement of market shares and market concentration is not an end in itself, but is useful to the extent it illuminates the merger's likely competitive effects."); European Comm'n, Guidelines on the Assessment of Horizontal Mergers Under the Council Regulation on the Control of Concentration Between Undertakings, 2004 O.J. (C 31) 5, ¶14 ("Market shares and concentration levels provide useful first indications of the market structure and of the competitive importance of both the merging parties and their competitors."), *available at* http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2004:031:0005:0018:EN:PDF.

[16] Cisco, *supra* note 7 at ¶52.

[17] *Id.*

The General Court explained that a market share presumption, even with a 90 percent market share, is not dispositive in high tech markets.[18] The Court reasoned that within "such a dynamic context, high market shares are not necessarily indicative of market power."[19] Similarly, in *Canon/Iris*, the Commission found a market share of up to 90 percent in some markets but also cleared the transaction without any remedies.[20] In yet another such example, the Commission unconditionally approved *ARM/Giesecke & Devrient/Gemalto*.[21] In that transaction, under a narrow market definition the parties would have held a 70-80 percent market share.[22] However, the Commission found that barriers to entry were low.[23]

### C. Interoperability

Interoperability between platforms and applications is a common concern within network industries. Interoperability was an issue that both *Microsoft/Skype* and *Intel/McAfee* addressed**.** The European General Court in *Microsoft/Skype* dismissed the interoperability issues. It made clear that free products did not create consumer harm because prices were not likely to increase and noted, "the fact that the services are offered free of charge is a relevant factor in assessing the market power of the new entity."[24] Any increase in prices seemed unlikely. Further, the General Court explained that Cisco's "reasoning is based not only on future and uncertain events, but also disregards the possibility that competitors of the new entity will adjust their marketing and technological strategies to anticipate and counteract a possible foreclosure strategy."[25]

The decision in *Microsoft/Skype* contrasts with that of *Intel/McAfee*. In *Intel/McAfee*, Intel, the world's largest computer chip firm, sought to acquire a security software company. The FTC cleared *Intel/McAfee* unconditionally. However, the EC sought access remedies in the same transaction.[26] Intel was required to disclose interoperability information to rival security software vendors (royalty free) and provide such vendors with related assistance.[27] The Commission also required that, as a design function, Intel not favor McAfee on its chips or degrade its performance on other chips.[28]

---

[18] *Id.* at ¶73 ("The fact that the services are offered free of charge is a relevant factor in assessing the market power of the new entity. In so far as users expect to receive consumer communications services free of charge, the potential for the new entity to set its pricing policy freely is significantly restricted. The Commission rightly observes that any attempt to make users pay would run the risk of reducing the attractiveness of those services and of encouraging users to switch to other providers continuing to offer their services free of charge.").

[19] *Id.* at ¶ 69.

[20] Case COMP/M.6773 - *Canon/ I.R.I.S.*

[21] Case No COMP/M.6564 - *ARM/ GIESECKE & DEVRIENT/ GEMALTO/ JV*.

[22] *Id.* at ¶65.

[23] *Id.* at ¶71 ("competitors would have the ability to develop alternative TEE solutions which, provided they are GlobalPlatform compliant, will interoperate with such ecosystem of trusted applications.").

[24] Cisco, *supra* note 7 at ¶73.

[25] *Id.* at ¶121.

[26] Case COMP/M.5984—Intel/McAfee, Comm'n Decision at 63 (Jan. 26, 2011), *available at* http://ec.europa.eu/competition/mergers/cases/decisions/m5984_20110126_20212_1685278_EN.pdf.

[27] *Id.* at ¶63-64.

[28] *Id.* at ¶65.

### D. Linkage Between Merger Control and Dominance Investigations

Behavior that merger control addresses through remedies (or lack thereof) also provides insight as to theories of harm and of remedies in dominance cases involving high tech markets. The nature of high tech markets suggests that caution may be necessary before intervening in a high tech case as much on the conduct side as on the merger side. The FTC closing statement in the Google investigation explained:

> Product design is an important dimension of competition and condemning legitimate product improvements risks harming consumers. Reasonable minds may differ as to the best way to design a search results page and the best way to allocate space among organic links, paid advertisements, and other features. And reasonable search algorithms may differ as to how best to rank any given website. Challenging Google's product design decisions in this case would require the Commission—or a court—to second-guess a firm's product design decisions where plausible procompetitive justifications have been offered, and where those justifications are supported by ample evidence.[29]

The United States is not the only jurisdiction that has identified the risk of intervention in high tech cases. The recent *Tencent* decision by the Chinese Supreme People's Court ("SPC") is instructive. The SPC found no dominance despite a market share of greater than 80 percent because of the fast moving nature of the internet, the free (or low price) nature of the product, the lack of switching costs, and the significant user multi-homing.[30]

The risk of harming consumers should drive decisions rather than third-party claims strategically pushed by competitor firms in high tech markets. This strategic misuse of antitrust by competitor firms remains a concern for both mergers and dominance cases.[31]

## IV. CONCLUSION

On substantive issues, many of the same concerns that mergers in the high tech sector raise also arise in dominance cases. Competition authorities should review facts carefully and understand particular markets before intervening. That all high tech markets (i) may not have significant network effects that impact competition, (ii) may not have traditional defined markets, and (iii) may not justify structural presumptions of significant market share leading to market power all suggest that competition authorities should be careful in identifying potential anticompetitive conduct and crafting appropriate remedies.

With investigations across numerous high tech companies in the United States, Europe, Latin America, and Asia, competition authorities need to be particularly aware of the stakes of

---

[29] Statement of the Federal Trade Commission Regarding Google's Search Practices, In the Matter of Google Inc. FTC File Number 111-0163 January 3, 2013, *available at* http://www.ftc.gov/sites/default/files/documents/public_statements/statement-commission-regarding-googles-search-practices/130103brillgooglesearchstmt.pdf.

[30] *See* generally, David S. Evans & Vanessa Yanhua Zhang, *The Qihoo v. Tencent Landmark Decision, Qihoo 360 v Tencent: First Antitrust Decision by The Supreme Court*, CPI Asia Column (Oct 21, 2014).

[31] *See* e.g., D. Daniel Sokol, *The Strategic Use of Public and Private Litigation in Antitrust as Business Strategy*, 85 S. CAL. L. REV. 689 (2012); R. Preston McAfee & Nicholas V. Vakkur, *The Strategic Abuse of Antitrust Laws*, 1 J. Strategic MGMT. EDUC. 3 (2004); William J. Baumol & Janusz A. Ordover, *Use of Antitrust to Subvert Competition*, 28 J.L. & ECON. 247 (1985).

investigations and decisions in rapidly evolving markets. Merger control, including remedies both taken and not taken, offers a number of suggestions as to thinking through case selection and remedies for dominance cases.