Presentation to FTC/DOJ Joint Hearings on Single Firm Conduct

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INTRODUCTION TO PRESENTATION

- QUALCOMM History and Business Model
- Antitrust/IP Issues in the Context of Standard Setting Organizations (SSOs)
  - The Diverse Nature and Interests of SSO Participants
- Concerns about Efforts to Fix a System that is Far From Broken
QUALCOMM Business Model – Technology Enabler

- QC chip/software platforms enable low cost entry for new manufacturers to drive competition
- QC R&D and chip/software development funded through sales and license revenue
IMPORTANCE OF STANDARDIZATION

A Number of Procompetitive Effects

- Product Interoperability
- Increase Consumer Choice
- Reduce Costs for Consumers and Producers
- Broaden Market Opportunities
Different Business Models and Incentives

- Firms participating in SSOs with different business models have different incentives when it comes to IP licensing:
  - Innovators (upstream) – Licensing revenues represent return on investment in innovation and are the lifeblood of these companies
  - Manufacturers/Implementers (downstream) – Want to pay lower royalties to reduce costs
  - Vertically-integrated firms (upstream and downstream) - Low royalties or even a zero royalty may be acceptable. Alternatively, they may want to raise rivals’ costs
  - Buyers of equipment – Also tend to believe that lower royalties would benefit them by reducing price of equipment
STANDARDIZATION AND THE FRAND REGIME

• Under traditional standards development procedures IPRs owners:
  
  ● Disclose the patents they consider may be essential for a standard
  
  ● Typically provide an assurance or commitment that, if their patents are included in a standard, they will license their essential patents on fair, reasonable and non-discriminatory (FRAND) terms and conditions
  
  ● This is not a small commitment as IPRs grant the right to exclude, i.e. not to make licenses available at all

• Licensing terms are discussed and negotiated, frequently in advance of a final standard, on a bilateral basis outside SSOs
FRAND WORKS

- FRAND regime has allowed successful development of innovative technologies (e.g., mobile telephony, Internet, WIFI, DSL, etc.) and has fostered competition

- Abuses of FRAND are rare (there is very little case-law) and involve intentional failures to disclose patents (patent ambush), not licensing terms
What are the theories underlying the suggestion that FRAND is not working well and that intervention is needed?

• Three main theories are advanced:
  • Lack of transparency: Some question generally whether there is sufficient information on the cost of implementing the standard
  • Hold up/ex-post opportunism: Once a standard has been adopted, holders of patents on technology for which there were practical alternatives in formulating the standard might seek to exploit their inclusion in the standard to charge “excessive” royalties in breach of their FRAND commitment
  • Royalty stacking: Cumulative royalty rates paid by users may be too high when the standard involves multiple essential patents held by multiple firms
Lack of Transparency

• This criticism is very weak:
  • Voluntary ex ante disclosure and negotiation on a bilateral basis is entirely consistent with the current FRAND regime which in no way prevents potential licensees from asking potential licensors about their planned licensing terms and conditions
  • This is not a theoretical possibility: It is frequently done in practice and potential licensors have every incentive to sign early deals – i.e. before the standard is adopted – in order to gain support for their technology from SSO members
  • In the unusual case that a potential licensor refuses to provide this information, potential licensees can choose to take this refusal into consideration when voting for the adoption of a given standard for which there are alternative technology solutions
Hold Up/Ex Post Opportunism

• There is little evidence that ex post opportunism is or would be a frequent occurrence
• Assumes alternative technologies existed at the time of selection (often not the case) and that insufficient information was available to make reasonable choices among such alternatives
• Essential IP holders are subject to a variety of constraints which prevent them from charging excessively high rates:
  • Horizontal constraints: an essential IP holder’s rates are constrained by the rates charged by other IP holders of complementary technology in the standard
  • Vertical constraints: no essential IP holder has an interest in killing the downstream market as its revenues are linked to the growth of this market
  • Dynamic constraints: standardization is a “repeated game” and essential IP holder charging excessive rates or conducting other abuses could be punished in negotiations leading to subsequent standards
Royalty Stacking

• Most of the literature claiming the existence of royalty stacking is theoretical in nature or based on inaccurate case studies
• There is little empirical evidence of royalty stacking in general and in the 3G industry in particular
• Geradin, Layne-Farrar and Padilla (2006) have demonstrated that the theory of royalty stacking is not robust
What is the true purpose of the attack on the FRAND regime?

• Since these criticisms do not hold and occurrences of abuses are very limited, less well intentioned explanations must be considered
• A range of industry players (as previously described) would find it attractive to shift whatever bargaining power they can away from the IP holders to the more numerous (and often larger) standard implementers
• This is nothing less than a general assault on the vitality of an innovation-producing patent system. Particularly troublesome are proposals to encourage joint discussion and negotiation of license terms, which seek exemption form antitrust rules to allow the exercise of joint purchasing power
Ex Ante Joint Negotiations

• The proposals for *ex ante* regime based on joint negotiations of licensing terms between and among a potential licensor and all licensees is made against a backdrop of existing widespread *ex ante* bilateral discussion and negotiation of licensing terms between potential licensors and all licensees.

• The problem is a familiar one - joint *ex ante* negotiations of royalties is likely to create strong collective buyer power and the exercise of monopsony or oligopsony power.

  • While joint negotiations of technical specifications among horizontal competitors are reasonably necessary to achieve interoperability (the very purpose of standards), joint negotiation of the price of technology to be purchased for use in the standard is both unnecessary and highly anticompetitive.

  • Moreover, joint negotiations would produce a “one-size fits all” approach preventing tailored licensing terms that promote the efficiency of each licensee (undermining the very flexibility of FRAND), and an inefficient homogenization of the conditions of competition also could facilitate collusion in downstream product markets.

• VITA’s policy, as understood by the Department of Justice in issuing its business review letter, professes to prohibit such joint actions (“The proposed policy should not permit licensees to depress the price of licenses for patented technologies through joint action because it prohibits any joint negotiation or discussion of licensing terms among the working group members or with third parties at all VSO and working group meetings”).

• Nonetheless, the DOJ has been interpreted by some as sanctioning the efforts of purchasers of patented technology to combine together to drive down the prices paid for that technology, without concern to its welfare reducing adverse impact on technology innovation companies.
Conclusions

• Licensing under FRAND conditions has proven successful. The evidence shows that it has spurred innovation and increased competition.

• Criticisms made against the FRAND regime fail to convince and efforts to move away from FRAND or to re-interpret this notion are essentially motivated by a consumer-welfare-reducing desire to suppress prices paid for patented technology.

Recommendation:
For the enforcement agencies asked to look at revisions to SSO policies – ask that particular attention be paid to the facts and circumstances that exist as to each such situation. Further – effort should be taken to avoid taking as gospel allegations of holdup and royalty stacking: The evidence isn’t there. Any suggestions for permissive joint activity has to be shown to be reasonably necessary to lead to an efficient result and not invite collusive action. IP “buyers” in SSO environment greatly outnumber (in the usual case) IP sellers.
Bibliography


