16 May 2013

THE COMPETITION COMMISSION OF FREEDONIA /

PATENTALIA Inc.
CT Case No: 01

Experts Meeting Joint Minute

13 and 14 May 2013

This document records the issues discussed in the meeting of experts and the core areas of agreement and disagreement. In some areas points have also been noted that were not raised or discussed in the meeting. The minute is not intended to replace any of the experts' respective reports and is not exhaustive in terms of the arguments made.

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Professor XX   Professor YY

Commission Economic Expert   Patentalia Economic Expert

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Date   Date

Patent hold up, hold out and royalty stacking				
Issue	**Agree/ Disagree**	**Commission Economic Expert's view**	**Patentalia Economic Expert's view**	**Comments**
Standardisation can give rise to considerable efficiencies	**A**	Standard setting organisations (SSOs) determine standards for the manufacture and use of certain technologies. SSOs have played a crucial role in the development of many high-tech industries, such as the mobile telephony industry.	Standardisation facilitates interoperability and results in considerable economies of scale and scope.	
Standardisation confers market power on selected technologies	**A (partial)**	Incorporation in a standard will increase market power by excluding existing and future alternative technologies. The market power may have been much weaker, or non-existent, if the technology had not been incorporated in the standard, because in that scenario other alternatives might have imposed a competitive constraint.	The impact of standardisation on market power depends on the existence of credible alternatives to the selected technology in the counterfactual scenario.	
SEP owners hold a dominant position	**D**	Owners of SEPs hold a dominant position because implementers have no option but to licence their technologies for use in their products.	SEP owners face a number of competitive constraints: buyer power, downstream competition, standardisation is a repeated game.	Existing models of SSO decision making are somewhat simplistic and miss key strategic considerations. These models are to the best of my knowledge static. More empirical work is needed: - Drivers of the selection process

Patent hold up is a serious problem	**D**	Once downstream manufacturers have adopted the standard and made specific investments to include it into their products, they may have given up the opportunity to choose alternative technologies. They can thus be "held up" by the licensors of the essential patents on which the standard depends: patent holders may be able to charge high royalties to manufacturers who cannot switch to another input. This is a serious problem in practice as the current wave of FRAND litigation and antitrust cases confirms.	Patent hold up is a theoretical possibility but there is little or no evidence supporting the claim that patent hold up is a severe problem. This may be because the FRAND commitment policy of SSOs works well or because SEP owners are not dominant for the reasons stated above.	More empirical research needed: - Analysis of litigation - Performance of standards under SSOs with different IP rules
Royalty stacking is a serious problem	**D**	The patent hold up problem is particularly severe for products that implement multiple patented technologies. The well-known Cournot problem applies: aggregate royalty rates are too high from a social viewpoint.	Royalty stacking is a theoretical possibility but there is little or no evidence supporting the claim that this is a problem in practice. This may be because patent hold up is not a problem, because of the development of market solutions such as cross licensing and pools, or because ownership of SEPs is high for many technologies.	More empirical research needed: - Same as above - Performance of standards with different degrees with SEP concentration
Reverse patent hold up is a serious problem	**D**	This concern is not SEP specific. If anything these problems should be less severe for SEPs. There is no evidence supporting this theory.	Implementers use all sort of tactics, including now antitrust litigation and regulatory intervention, to avoid paying royalties or to minimise the amount that is paid. These tactics are relatively more successful when SEP owners are not VI and are cash-constraint.	More empirical research is needed: - Analysis of litigation: injunction cases

FRAND royalties				
Issue	**Agree/ Disagree**	**Commission Economic Expert's view**	**Patentalia Economic Expert's view**	**Comments**
FRAND commitments preclude constructive refusals to deal. FRAND commitments involve an FR commitment and an ND commitment	**A (partial)**	This is true but it is not saying much. The exploitation of the market power conferred by the standardisation process may potentially restrict or distort competition in downstream markets. SSOs therefore often set rules aimed at preventing IP right owners who hold SEPs from exploiting the resulting increase in their market power.	FRAND is a commitment to negotiate in good faith. In principle, any non-exclusionary royalty — i.e. any royalty short of creating a "constructive" refusal to deal — would satisfy the FR principle.	
FR royalties should be equal to the royalty rates that would have obtained in a counterfactual world with no standard	**A (partial)**	FRAND royalties should be determined by reference to a hypothetical counterfactual situation in which this market power does not exist. This counterfactual is the situation that would exist if the standardisation process had not eliminated the competitive constraints that existed before the adoption of the standard. Before the standard is defined, the patent in question would be licensed under terms reflecting, inter alia, the level of competition on the relevant (technology) market. If alternative technologies exist, they would constrain, at least to a certain extent, the royalty rate the patent holder could charge for its technology.	Under the counterfactual approach, an FR royalty rate reflects (a) the incremental value that the SEP brings to the product, as compared to the value that would have been created by the inclusion of the next-best alternative technology; and (b) the incremental value of the SEP relative to the incremental values of the other (complementary) essential patents reading on the same standard. The counterfactual royalty rate will be small if either (a) or (b) are small, and will only be high if both (a) and (b) are high.	How should we define the counterfactual scenario? - Static view: ex ante scenario - Dynamic view: the scenario that would have developed in the absence of standardisation

FR royalties should be determined assuming that SEPs are valid and infringed	**D**	No. Patents are probabilistic.	Yes. Validity should be analysed separately.	More theoretical research is needed. - The practical question is whether a court/arbitrator should presume the patent to be valid or not. Different presumptions may lead to very different numbers depending on the institutional setup.
FRAND commitment implies cash-only offers	**D**	Yes. An SEP owner under a FRAND commitment should not be able to leverage the market power conferred by the standard to extract cross-licenses or any other terms.	No. This is inconsistent with the counterfactual approach above.	More theoretical research needed. - What are the implications of different answers on participation incentives?
FR royalties should not be determined using the ex-ante auction approach	**A (partial)**	Yes. The commitment to license to all comers makes the auction approach proposed by some inappropriate.	Yes. However, the ex-ante auction approach is not about auctioning a limited number of licenses. It is just another name for the counterfactual approach where the counterfactual is the ex-ante scenario. There are many reasons why one should not apply mechanistically the ex-ante benchmark proposed by Swanson and Baumol. My proposal is to use the ex-ante auction framework to construct a "sufficiency test" (i.e. to define a safe harbour). Evidence that ex-post and ex-ante licensing terms coincide would be sufficient, though not necessary, in order to establish compliance for FRAND purposes.	

FR royalties should be determined under the so-called incremental value rule	**D**	Yes. An SEP owner who makes a FRAND commitment cannot charge more than the incremental value of its technology.	No. The incremental value of the technology is a relevant factor in the determination of the FR royalty, but the strict application of the IV rule would discourage investment and SSO participation.	More theoretical research is needed: - Dynamic v. static counterfactual (see above) - Impact on investment decisions using patent race models - Impact on participation decisions
The FR rate for an SEP portfolio should be determined taking into consideration the royalties charged for all other SEPs	**D**	Yes. Otherwise FRAND commitments would not address the royalty stacking problem.	No. This is inconsistent with the counterfactual approach. FRAND commitment does not imply commitment to form part of a patent pool or pseudo patent pool. Royalty stacking is not a big problem. It is however important to take into consideration the relevant contribution of the SEP in question.	More theoretical research is needed: - Impact on investment decisions - Impact on participation decisions
FR royalties should not be determined under the so-called numerical proportionality rule	**A**	Yes. This rule makes no sense because it treats all patents as equally valuable which cannot be true in the absence of a standard.	Yes. This is inconsistent with the counterfactual approach.	

Injunctions				
Issue	**Agree/ Disagree**	**Commission Economic Expert's view**	**Patentalia Economic Expert's view**	**Comments**
FRAND commitments preclude patent injunctions	**D**	Yes. Patent injunctions can only exacerbate the patent hold up problem. An SEP owner under a FRAND commitment is only entitled to monetary damages. SEP owners under a FRAND commitment should not seek injunctions unless they can demonstrate that implementer is not a willing licensee.	No. Patent injunctions address reverse patent hold out situations. Courts should grant injunctions unless the implementer can show that no FRAND offer was made.	More theoretical research needed: - What are the implications of alternative allocations of the burden of proof - What is a willing licensee
Patent injunctions should be denied to NPEs and PAEs	**D**	Yes. They are trolls. Any rents appropriated by them are wasted from a social viewpoint.	No. NPEs invest in R&D and are as entitled to obtain compensation for their investment as VI companies. PAEs may serve a social role as well since they allow small innovators to monetise their investments. No justification for privateering PAEs though.	