

INTELLECTUAL PROPERTY, COMPETITION, AND INNOVATION: U.S. DEVELOPMENTS
What is Next in Innovation, Intellectual Property and Standard Essential Patents?
MLex Market Insight Seminar
Brussels, Belgium
December 6, 2016
Remarks of Commissioner Terrell McSweeney¹

Good afternoon. Thank you, Robert, for the introduction, and thank you to MLex for inviting me to participate in this panel. It is a pleasure to be with you today.

We live in an age of innovation. Technology is producing changes in our lives and changes in the economy at a rate not seen since the Industrial Revolution. I feel fortunate to be at the Federal Trade Commission during this era of rapid change.

Today I will talk about some of the initiatives the FTC has been involved with related to innovation and intellectual property. I will also share my perspective on SEPs and their role in innovation.

IP Licensing Guidelines

F'11 1

innovation, but that there are situations in which IP licenses may harm competition.

Portfolio PAEs negotiate licenses covering large portfolios – frequently without suing the alleged infringer. Their licenses often included more than 1,000 patents and generated royalties of greater than a million dollars. Portfolio PAEs accounted for less than 10% of the reported licenses in the study, but those licenses generated 80% of the total PAE licensing revenue we observed, or approximately \$3.2 billion dollars.⁵

Litigation PAEs, on the other hand, generally only negotiated licenses after suing the licensee and tended to settle lawsuits quickly.⁶ Litigation PAE license amounts were generally small

standard itself, rather than the value of the underlying intellectual property.¹³ In the 2014 case of *Ericsson v. D-Link*, the U.S. Federal Circuit held that the principle that “the patent holder should only be compensated for the approximate incremental benefit derived from his invention . . . is particularly true for SEPs.”¹⁴

Hold-up is a standard, straightforward concept in economics. Oliver Williamson won the Nobel Prize in economics in 2009 due in no small part to his work showing how opportunistic behavior such as hold-up can lead to inefficient economic outcomes.¹⁵

Patent hold-up can hamper standard-setting efforts, distort incentives for innovation, and potentially lead to higher prices and reduced output for consumers.¹⁶ Hold-up becomes an antitrust issue when parties obtain their leverage as a result of the standard-setting process, which substitutes collective decision making for market forces.

Thankfully, SSOs themselves developed a mechanism to address this inefficient and opportunistic behavior – namely, the commitment by a patent holder to license its intellectual property on fair, reasonable, and nondiscriminatory (FRAND) terms in exchange for inclusion in a standard. I want to emphasize that FRAND commitments arose organically among standard-setting organizations (SSOs), and were not imposed on SSOs by governments or other outside parties.¹⁷

By making a FRAND commitment, an SEP-holder chooses to monetize its technology through licensing rather than through exclusion. This makes it inappropriate, in most circumstances, for an SEP-holder to seek injunctive or exclusionary relief. As Carl Shapiro has explained, “[t]he economics here clearly teaches us that exclusion orders or injunctions tip the balance of power in negotiations towards royalties that are excessive rather than just reasonable.”

¹³ As a general principle, a FRAND rate should reflect value that the patented technology brings to consumers, relative to the other technologies available when the technology was chosen for the standard. *See, e.g., Ericsson, Inc. v. D-Link Systems, Inc.* 773 F.3d 1201, 1235 (Fed. Cir. 2014) (“We further hold that district courts must make clear to the jury that any royalty award must be based on the incremental value of the invention, not the value of the standard as a whole or any increased value the patented feature gains from its inclusion in the standard”).

¹⁴ *Ericsson, Inc. v. D-Link Systems, Inc.*, 773 F.3d 1201, 1223 (Fed. Cir. 2014).

¹⁵ *See* Avanish Dixit, Remarks at the AEA 2011 Nobel Lunch Honoring Elinor Ostrom and Oliver Williamson, January 8, 2011, at 3, <https://www.princeton.edu/~dixitak/home/NobelLunchTalkJan2011.pdf>.

The threat of hold-up risks reducing incentives for downstream innovation.

If companies can expect to face demands from SEP-holders that go well beyond what is fair and reasonable, that affects their decision about whether to invest in developing innovative products that implement the underlying standard.

If companies who are willing to pay a fair and reasonable rate may nonetheless face an