Faculty Development Program

on

Intellectual Property, Innovation and Competition

15th December 2018 | New Delhi, India

This report summarizes proceeding of Faculty Development Program conducted by CUTS Institute of Regulation and Competition (CIRC) under the project entitled, "CompIP".

Background

CUTS Institute for Regulation & Competition (CIRC) organised a Faculty Development Program on December 15, 2018 at New Delhi on "Intellectual Property, Innovation and Competition" as a part of Comp-IP Project - phase 2. The workshop consisted of 3 sessions and a panel discussion. The sessions focussed on the economics of platform markets; standard essential patents (SEPS), FRAND; and the interface between Intellectual Property, Innovation and Competition. The workshop was attended by Law faculty from Universities like Symbiosis, Amity etc. and lawyers.

Proceedings

Session 1: Economics of Platform Markets

(Speaker: Ms. Payal Malik, Advisor – Competition Commission of India)

Platform markets (often referred to as two-sided or multisided markets) are characterized by network externalities. In such markets, firms are called platforms that serve two (or more) distinct groups of consumers. In multi-sided platforms, network externalities become cross-sided or indirect. For example, in case of Google search engine, more searchers on one side of the platform leads to more advertisers on the other side (cross sided network externalities).

Another important feature of markets with network effects is inefficiency of perfect competition. Since perfect competition provides smaller network than is socially optimal, it is not able to reap the benefits of network effects. Therefore, in such a market "winner-takes it all". It means an efficient firm that captures the entire demand, at least, cost internalizes the network externalities and becomes the leading firm with extreme market share. These features enable firms to adopt a complex pricing strategy where firms do not choose a single price for all set of consumers, rather choose a 'pricing structure', where some set of consumers are not priced at all (zero pricing) and other set of consumers are subsidized to create positive externalities.

Due to the given characteristics of platform markets, some firms become big and concentrated because of natural equilibrium of exploitation of the network effects. There are empirical evidences that suggest that there exists intense competition in innovative activities in network industries, financed by capital markets. Schumpeterian race of market dominance suggests that though it may appear that monopolies are existing in these industries; it is only the outcome of the ecosystem of intense competition. Such competition is ex-ante among firms that invest in these industries to attain a monopoly position. Innovation happens because of the reward at the end of the race.

Session 2: Intellectual Property Rights and Anti-Competitive Practices

(Speaker: Dr. Derek Ritzmann, Director – Economics Partners)

Intellectual Property Right (IPRs) is the subset of property rights and involves inter-firm and inter-brand competition to get temporary monopoly position over distinct platform and hence consumer welfare is maximized in the process. The ownership of IP rights does not necessarily confer market power and it leads to 'Essential Facility Doctrine (EFD)". Under this doctrine, an entity that owns the IP rights on any

facility that is essential to other competitors or other players in upstream and downstream market has the obligation to provide a reasonable use of that facility. The landmark US case under this doctrine is *Verizon vs. Trinko*, 540 U.S. 398 (2004). However, the doctrine is never used in IP context in US courts.

Essential facility doctrine becomes more imperative in case of standards. Technology standards are common specifications that have been approved by a Standards Setting Organization (SSO). These standards form the foundation of economic transaction and allow product compatibility and interoperability. Standardization is important in telecommunication industry. This industry relies on 2G (GSM), 3G (UMTS) and 4G (LTE) standards, and also WIFI standards which comprises a great number of R&D intensive innovations protected by patents. Patents that are essential to comply and implement a specific industry standard, which are considered as 'Standard Essential Patents'. Owner of SEP has increased bargaining position and can kill applicability of that standard by refusing to license that leads to economic 'hold up problem'. This problem is solved through the requirement of licensing at FRAND terms i.e. Fair, Reasonable and Non-Discriminatory. The discussion was held on determining the reasonable royalty based on The Georgia Specific Factors in the U.S. In determining reasonable royalties, the fifteen factors were listed in *Georgia-Pacific Corporation vs. United States Plywood Corp.* (1971). These factors were discussed in the Game Theory context where the Nash equilibrium bargaining solution is determined for a hypothetical negotiation. Further, antitrust issues based on the European Commission case of *Microsoft vs. Sun Microsystems* were also discussed.

Session 3: Interface between IP, Innovation and Competition Law

(Speaker: Ms. Payal Malik, Advisor – Competition Commission of India)

Economic literature establishes a positive linkage between innovation and economic growth. No longer can countries hope to grow only on the basis of cheap labor and capital accumulation, but they need to have R&D and innovative capabilities. Innovative capacity, which is spurred by appropriable knowledge and technological externalities, transforms the production possibility frontier. Thus, innovation has become centerpiece of industrial organizations, where competition is not only merely based on prices (static competition), but on innovation and ability to commercialize knowledge.

Competition law and IP law, both, are integral to building innovation ecosystem and developing knowledge economy. IP law does it in ex-ante mechanism by conferring exclusive rights to the intellectual assets. Competition law, on the other hand, ensures that the use of exclusive rights is not disproportionate to the intellectual property and innovation capability, and hence, is not harming the competition and consumer welfare. Consumer welfare standard should not be looked at as a static standard based on price. It should also include the aspect of innovation as a strategic tool. R&D involves a substantial amount of risk and imitation could curtail the incentive to innovate. IPR guarantee appropriability and creates the right kind of incentive structure. Competition law attempts to see whether or not that incentive structure is maintained.

Some degree of allocative inefficiency (P>MC) is required to get the rate of return for risky R&D investment. That's where the problem arises in competition law by narrowly looking at consumer welfare

in terms of low prices. Empirics suggest that in innovating markets, competition assessment should not be based on prices. It should involve dynamic aspects. It is needed to look at the conduct of IP owner through questions like: Whether IP owner is inimical to innovation or it allows innovation to flourish. Is IP owner licensing it to be used by downstream firms? Are licensing agreements reasonable or designed to extract maximum rents from downstream implementers? For that, reasonability tests need to be done by the competition authority to look at the terms of the licensing agreements.

Panel discussion

Moderator: Saattvic Saattvic, Senior Consultant – Economic Partners

Panelists

Ms. Payal Malik, Advisor – Competition Commission of India

Dr. Derek Ritzmann, Director – Economics Partners

Mr. G. R. Bhatia, Partner and Head of the Competition Law Practice, L&L Partners; former Additional Director General of the CCI

1. Economics of Common Ownership and Competition Law

Discussion began by laying out the foundation of growth of common ownership by investment funds and gradually proceeded to discuss the anticompetitive implications of it. Common ownership is an important issue that antitrust authorities have to deal with. Whether or not intervention and what kind of intervention or remedied these antitrust authorities provide? Are the remedies at counter-purpose to the objectives of the stability of financial market? What are the channels of institutional investor's influence? Is it by majority voting or voting as a block (by collecting other large investors and vote as a block to the detriment of other retail investors)? Loads of empirical studies and their econometrics aspects are questioned about the common ownership and lack of competition. Cross-ownership, exchange of board members and flow of information between companies has been considered as a very significant problem from competition perspective. The relationship between common ownership, prices and completion has been empirically tested. One of those studies found roughly around 5% correlation between prices and common ownership. However, many other empirical papers have questioned these results asking for the mechanism through which common ownership and price is correlated. The main issue is how the passive ownership of different companies which are competitive firms somehow automatically leads to competition problem. When Ola and Uber case was brought to Competition Commission of India (CCI) by Meru travels solutions limited, two issues were considered by Competition authority- whether these investments are passive investments and how control is exercised to voting rights, nomination of directorship etc. The panelists emphasized that the problem with common ownership is not that it would lead to collusive outcome, but overlapping ownership interest among competitors may imply reduction in incentives of the firms to compete.

2. Economic Analysis of Innovative / High Technology Mergers

The panel discussion started with the question: how the possession of large amount of data about consumers lead to competitive harm? It was discussed that ownership and control over data is being considered as power as far as dominance is concerned. The fact that with the possession of big data and

it's processing enables a firm to come out with innovative product is one of the factors to assess the dominance of the firm. Regarding mergers and acquisition there is a statutory lacuna because there is no valuation of the data. Unstructured data that has not been worked upon is not considered valuable at all by the current regulation that leads to undervaluation of firm's assets. If a company is acquired purely based upon its large holding of data, in the current scenario asset value of that firm would be equal to zero e.g. acquisition of WhatsApp by Facebook.

Before declaring that data is worth something and is an important asset of the acquired firm, one needs to look at pre-existing relationship i.e. the network effects that exists. If that network effect has not been accounted for, then valuation of data becomes problematic. There was also a debate about the public good nature of data that changes the analysis of dominance. Relevant market definitions in itself are becoming more complicated in such cases. The fact that antitrust cannot treat it ex-post completely leads to ex-ante regulation of data that in turn leads to more and more concentration of data with few parties.

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