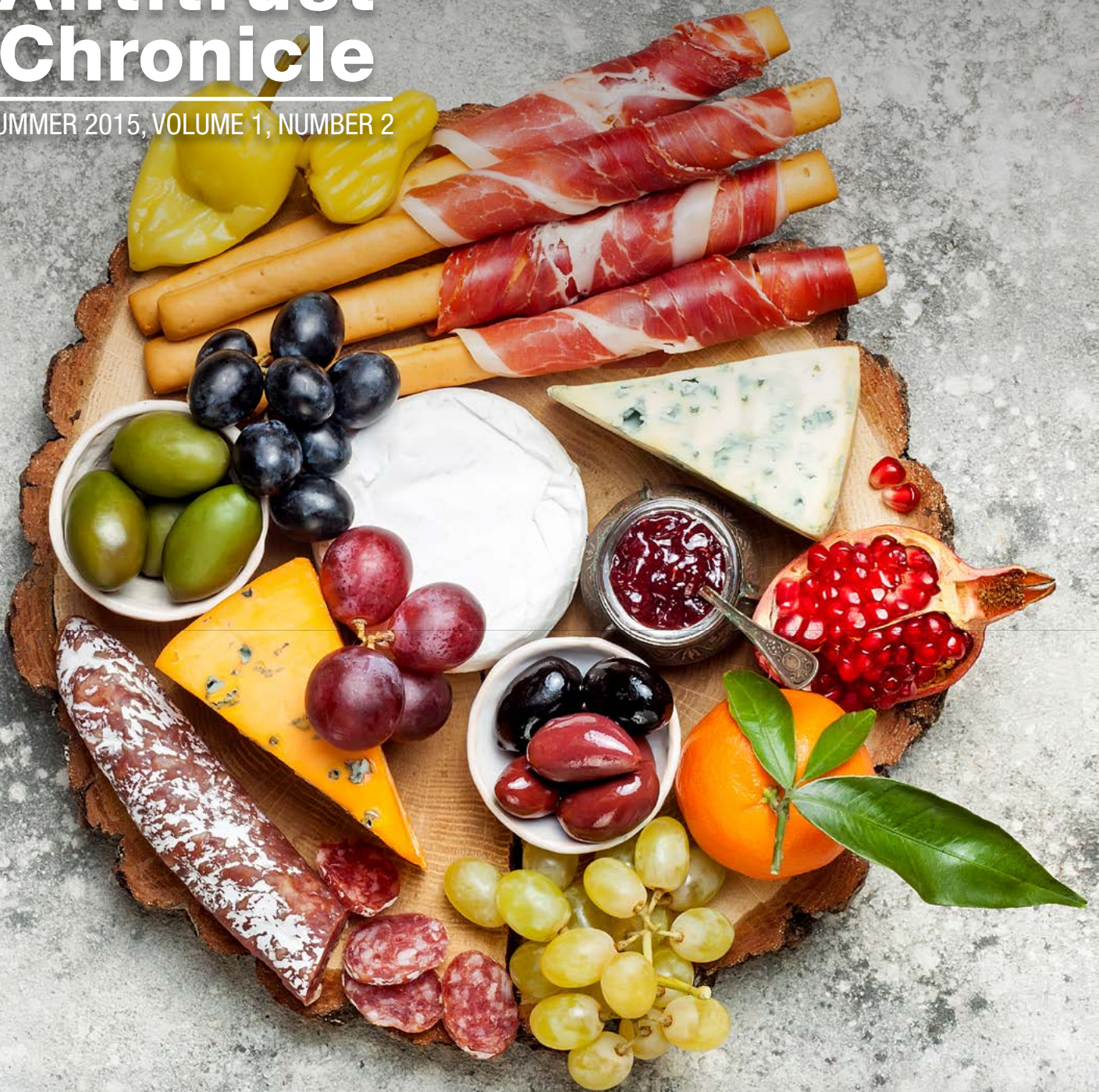


Antitrust Chronicle

SUMMER 2015, VOLUME 1, NUMBER 2



Antitrust Antipasto

CPI Antitrust Chronicle

July 2015 (2)

Healthcare Merger Antitrust Review: Increased Scrutiny For Any Provider Merger

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Healthcare Merger Antitrust Review: Increased Scrutiny For Any Provider Merger

David Balto & James Kovacs¹

I. INTRODUCTION

For nearly the last decade, there has been increased emphasis on controlling healthcare spending and costs in the United States. State and federal antitrust enforcement agencies have taken on a renewed focus of provider consolidation in attempts to implement cost containment in the healthcare system for both consumers and payors.² These agencies, specifically the Federal Trade Commission (“Commission”), have been reinvigorated in recent years to litigate and prevent potentially anticompetitive healthcare provider mergers.³ However, whereas previously the focus of the Commission and other enforcement agencies has been on horizontal mergers—i.e. a hospital acquiring another hospital—there is also now increasing interest in vertical combinations—i.e. a hospital acquiring a physician practice.⁴

As a result of heightened scrutiny by the enforcement agencies, provider groups seeking both vertical and horizontal acquisitions and collaborations face complex antitrust and regulatory challenges. As Assistant Attorney General Bill Baer recently said, “merger enforcement, in particular, is a predictive exercise.”⁵ Merging provider parties aware of the recent agencies actions will be better prepared to defend their transactions before the agencies, or a court if necessary. First, understanding the agencies’ stance on merger efficiencies is key for merging parties. Second, there are likely different remedies to potentially anticompetitive mergers depending on whether a transaction is being reviewed by the federal government or a state government. Third, knowing the regulations of various states is necessary to understanding the pulse of the state agency reviewing a merger.

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² See generally Martin Gaynor & Robert Town, *The Impact of Hospital Consolidation—Update*, ROBERT WOOD JOHNSON SYNTHESIS PROJECT, 1, 1 (2012), available at <http://goo.gl/KVtEyF> (discussing numerous economic studies finding price increases as a direct consequence of hospital and provider consolidation).

³ While the Commission typically handles healthcare provider mergers, the Department of Justice Antitrust Division has also shown an interest in preventing mergers between providers that they deem would harm competition. See Bill Baer, Assistant Attorney General, U.S. Dep’t of Just., Antitrust Div., Opening Remarks: Workshop on Examining Health Care Competition (Feb. 25, 2015), available at <http://goo.gl/anQvw6> (in discussing healthcare provider mergers, “we stand ready to take appropriate enforcement action against transactions that harm competition.”).

⁴ See Edith Ramirez, *Antitrust Enforcement in Health Care—Controlling Costs, Improving Quality*, 371 NEW ENG. J. MED. 2245, 2246 (2014) (“Similar concerns arise when physician groups combine or when doctors sell their practices to hospitals.”).

⁵ DOJ’s Antitrust Division Kept Busy by Increased M&A, BLOOMBERG BUS. (July 15, 2015 8:53 AM), <http://goo.gl/ToBH5V> (at 1:49).

This article discusses recent developments in healthcare provider mergers following the above. First, it notes the role of efficiencies post-*St. Luke's*. Second, the article scrutinizes the use of remedies by federal and state enforcers. Third, it examines the increased usage of state legislation and regulation. And finally, the article briefly discusses the potential impact of health insurance mergers on healthcare providers.

II. NON-COST EFFICIENCIES DEFENSE IN PROVIDER MERGERS: THE ST. LUKE'S DECISION CLOSES DOORS

Merging parties have often relied on pro-competitive efficiencies as a rebutting presumption to potential anticompetitive harm. In the healthcare context, beyond cost-savings, providers have previously relied on efficiencies that establish “better medical care” to survive a merger challenge.⁶ However, there has been a systemic shift in reviewing efficiencies associated with mergers among healthcare entities. This shift stems from increased reliance on the structural presumption and the 2010 Merger Guidelines.

The structural presumption model from *United States v. Phila. Nat'l Bank*⁷ requires plaintiffs only prove undue concentration through presumptive models, not actual anticompetitive effects.⁸ In contrast, under the structural presumption, defendants are required to rebut the presumption of competitive harm via actual proof.⁹ In instances where parties rely on an efficiencies defense to rebut the presumption of harm, the Department of Justice and Federal Trade Commission's 2010 Horizontal Merger Guidelines further complicate the issue. Under the Guidelines, a party's stated efficiencies must be “merger-specific,” “substantiated,” and “cognizable,” making proving efficiencies for merging parties decidedly more difficult.¹⁰

The recent *St. Luke's* case provided an in-depth view of how federal enforcers and courts view healthcare efficiencies using this analysis. The case involved a vertical transaction between St. Luke's Health System (“St. Luke's”) and Saltzer Medical Group (“Saltzer”)—an independent physician practice with 41 physicians including 16 primary care doctors in Nampa, Idaho.¹¹ Along with a private lawsuit, the Commission reviewed the transaction under a horizontal theory, analyzing the horizontal overlap between Saltzer's and St. Luke's combined market share in the adult primary care market.¹²

However, St. Luke's responded that such a transaction was purposed with moving the parties away from ineffective fee-for-service payments towards integration between the provider groups, thus leading to better coordination and care. In assessing the transaction's efficiencies, the district court agree with St. Luke's analysis finding that, if the merger were “left intact,” the

⁶ See *FTC v. Tenet Health Care*, 186 F.3d 1045, 1054 (8th Cir. 1999).

⁷ 374 U.S. 321 (1963).

⁸ See *St. Alphonsus Med. Ctr. v. St. Luke's Health Sys.*, 778 F.3d 775, 788 (9th Cir. 2015) (stating that “the extremely high HHI (Herfindahl-Hirschman Index) on its own establishes the prima facie case.”).

⁹ See *ProMedica Health Sys., Inc. v. FTC*, 749 F.3d 559, 571 (6th Cir. 2014) (“The remaining question is whether ProMedica has rebutted that presumption.”).

¹⁰ See § 10.

¹¹ *St. Luke's Health Sys.*, 778 F.3d at 781.

¹² *Id.*

efficiencies it created would improve care for patients in Nampa.¹³ Yet, the lower court determined that the touted quality of care enhancing efficiencies could not be counted because they lacked merger-specificity.¹⁴

On appeal, the Ninth Circuit went a few steps further in dismissing non-cost-savings related efficiencies. After reviewing both the relevant case law and the Merger Guidelines, the Ninth Circuit stated that an efficiencies defense must demonstrate “that the prima facie case ‘portray[s] inaccurately the merger’s probable effects on competition.’”¹⁵ Under that standard, the Ninth Circuit found that improvements in care should not be considered:

But even if we assume that the claim efficiencies were merger-specific, the defense would nonetheless fail. At most, the district court concluded that St. Luke’s might provide better service to patients after the merger. That is a laudable goal, but the Clayton Act does not excuse mergers that lessen competition or create monopolies...¹⁶

The Ninth Circuit’s decision in *St. Luke’s* raises the question if merging parties should offer quality of care efficiencies in merger cases. In response to scholarly analysis of the decision, the Commission has publicly stated that the opinion is “consistent” with the Merger Guidelines’ standard of requiring parties prove efficiencies instead of relying on potential outcomes.¹⁷ Providers considering using improvement in quality of care as a merger efficiency and defense must present clear, concrete evidence of improvement. Yet, under the analysis of the structural presumption, no federal appellate court has ever relied on any type of efficiency to overturn a *prima facie* case.¹⁸ Therefore, quality-enhancing efficiencies in the healthcare merger context should be considered as bolstering arguments for a merger, not the only line of defense against objections to that merger.

III. MERGER REMEDIES: GOVERNMENT SAYS DIVESTITURE IS KING, STATES CONSIDER BEHAVIORAL FIXES

As part of the renewed interest in healthcare mergers, in 2007, the Commission sought and won a case involving the combination of two hospitals in the Chicago area, the first victory for the Commission since 1991.¹⁹ However, instead of requiring the parties to divest and return to operating separately, the Commission issued a conduct remedy requiring the hospitals use “separate and independent negotiating teams” for payor contracting.²⁰ Yet, since the *Evanston*

¹³ Findings of Fact and Conclusions of Law, *F.T.C. v. St. Luke’s Health System, Ltd.*, Case No. 1:13- CV-00116-BLW at *3 (D. Idaho Jan. 24, 2014).

¹⁴ See *Id.* at *34 (“a committed team can be assembled without employing physicians”).

¹⁵ *St. Luke’s Health Sys.*, 778 F.3d at 790 (citation omitted).

¹⁶ *Id.* at 791-92.

¹⁷ See Terrell McSweeney, Commissioner, Fed. Trade Comm’n, 2015 Annual Antitrust Spring Seminar (Apr. 28, 2015), available at <http://goo.gl/anQvw6> (noting that “St. Luke’s had a desire to improve quality” but “there was nothing in the record to show it had increased quality in previous acquisitions, or that it had anything more than a ‘laudable goal’”).

¹⁸ See *St. Luke’s Health Sys.*, 778 F.3d at 789.

¹⁹ Opinion of the Commission, *In the Matter of Evanston Northwestern Healthcare Corp.*, F.T.C. No. 9315 (Aug. 6, 2007).

²⁰ *Id.* at 89-90.

case, the Commission has rarely employed a conduct or behavioral remedy,²¹ and instead has consistently relied on structural remedies such as divestitures.²² Federal courts have followed the lead of the Commission rejecting merging parties proffered conduct remedies in both *St. Luke's* and *ProMedica*.²³

While the federal enforcers are unlikely to offer or grant a conduct remedy, state antitrust enforcers are more willing to engage merging parties. In recent years, there have been a number of potential anticompetitive provider mergers wherein parties entered into consent decrees with states attorney generals.²⁴ The most complex and encompassing attempted conduct remedy involved Massachusetts' Partners HealthCare ("Partners").

Partners, the largest healthcare provider in Massachusetts, sought to acquire both South Shore and Hallmark hospital systems—a transaction involving three hospitals and 450 physicians in the greater Boston area. Instead of litigating the matter and seeking divestiture, former Attorney General Martha Coakley sought a court order consent decree allowing the parties to merge, but with a number of conditions.²⁵ The conduct remedy was incredibly complex and included provisions for (1) price caps; (2) limiting future hospital and physician acquisitions; (3) component contracting for payors; and (4) an appointed, unaffiliated monitor of the merger that would serve for ten years.²⁶

The conduct remedy was supported by Pennsylvania Attorney General's Office, a state that has entered into numerous conduct remedies with a number of healthcare provider groups over the last five years.²⁷ However, the Partners conduct remedy did not come to fruition. Due in

²¹ See *In the Matter of Renown Health*, F.T.C. C-4366 (Dec. 4, 2012) (consent decree involving Renown suspending usage of non-compete agreements until at least six cardiologists terminated contracts); Agreement Containing Consent Order, *In the Matter of Phoebe Putney Health Sys., Inc.*, F.T.C. No. 9348 (Aug. 22, 2013) (after the Supreme Court decision finding that state immunity did not apply, the Commission entered into a consent decree with Phoebe Putney requiring that the hospital not acquire additional acute care hospital or physician practices and prohibited Phoebe Putney from objecting to certificates of needs).

²² See Deborah L. Feinstein, Director, Bureau of Competition, Fed. Trade Comm'n, Antitrust Enforcement in Health Care: Proscription, not Prescription (June 19, 2014), available at <https://goo.gl/n7mDKf> (noting that the Commission now "repeatedly reject[s] this sort of conduct remedy.").

²³ *St. Luke's Health Sys.*, 778 F.3d at 793-94; *ProMedica Health Sys.*, 749 F.3d at 573.

²⁴ E.g. Press Release, N.Y. Att'y Gen., A.G. Schneiderman Announces Settlement With Utica Hospitals To Address Competitive Concerns (Dec. 11, 2013), available at <http://goo.gl/HjSPXI> (allowing merger of Utica's two largest hospitals but requiring parties eliminate usage of most-favored-nation contracting clauses and achieve stated efficiencies); Consent Decree, *State of Maine v. MaineHealth*, No. BCD-CV-11-08 (Me. B.C.D. Jan. 3, 2012) (allowing vertical acquisition of cardiologists by hospital as long as parties accepted a number of conditions including not requiring hospital rates for outpatient cardiology services).

²⁵ See Press Release, Massachusetts Attorney General Martha Coakley, AG Final Resolution with Partners Would Alter Provider's Negotiating Power, Restrict Growth and Health Costs (June 24, 2014), available at <http://goo.gl/oXJRya>.

²⁶ *Id.*

²⁷ Public Comment by James A. Donahue, Executive Deputy Attorney General for Penn., *In re Comm. of Mass. v. Partners Health Sys., Inc., South Shore Health and Ed. Corp., and Hallmark Health Corp.*, Civil Action No. 14-2033-BLS (Mass. Superior Ct. Aug. 28, 2014).

large part to outcry from economists, consumers groups, and other Boston-area hospitals, Judge Sanders rejected the settlement noting that it would “cement Partners’ already strong position.”²⁸

As providers move forward with mergers, it is important to note how different agencies, federal and state, could respond in the event of litigation. Given its recent public statements and the case law, it appears that the Commission has a well-established pension for only using structural remedies. And while states are more willing to consider a conduct remedy, it is not guaranteed to be successful in the courts or necessarily in the best interests of the parties.

IV. STATE LEGISLATION: ENGAGING AND DISENGAGING ANTITRUST REVIEW

Along with federal and state antitrust laws, most states have an extra layer of regulatory compliance mandating merging providers meet state requirements. These additional requirements can be burdensome or helpful to merging parties depending on the state.

Nowhere is healthcare provider merger regulation more pronounced than in the Commonwealth of Massachusetts. As part of the Commonwealth’s policies to reduce healthcare cost growth and improve quality of care, the state passed Chapter 224, or the health cost containment law, which created the Health Policy Commission (“HPC”).²⁹ The HPC has been granted the power to “assess[] the impact of healthcare market changes” by investigating provider mergers within the state.³⁰ In fact, it was data collected by the HPC that greatly influenced Judge Sanders to reject the Partners settlement.³¹

More recently, the Commonwealth has looked to expand the HPC’s powers. A proposed bill would allow the HPC’s report on any merger to act as “‘prima facie evidence’ to prove a violation of the state’s consumer protection statute.”³² By increasing the power of the HPC, the Commonwealth’s Attorney General will now have more tools to block potential anticompetitive mergers between healthcare providers.³³

On the other side of the spectrum is New York. New York is implementing a Delivery System Reform Incentive Payment (“DSRIP”) program, designed to improve the state’s Medicaid program with a primary goal of reducing avoidable hospital visits by 25 percent within five years.³⁴ Payouts of the program require significant coordination and collaboration among

²⁸ *In re Commonwealth of Mass. v. Partners Healthcare Sys., Inc.*, No. SUCV2014-02033-BLS2, 2015 Mass. Super at *2 (Mass. Super. Court, Suffolk County, Jan. 29, 2015).

²⁹ *Health Policy Commission*, MASS.GOV, <http://goo.gl/uLddQ8> (last visited July 17, 2015).

³⁰ *Id.*

³¹ See generally *Partners Healthcare Sys., Inc.*, No. SUCV2014-02033-BLS2 (discussing the HPC’s findings throughout).

³² Shira Schoenberg, *AG Maura Healey backs bill giving more power to Massachusetts’ Health Policy Commission*, MASSLIVE (Apr. 7, 2015 6:08 PM), <http://goo.gl/xkSGyp>.

³³ Connecticut has also taken a similar approach. Under Section 1 of P.A. 14-168, An Act Concerning Joint Ventures and Affiliations of Group Medical Practices, “[a]ny party to a transaction that results in a ‘material change to the business or corporate structure of a group practice’” must submit written notice to the Attorney General within 30 days. *Notice of Material Change Form*, CONNECTICUT, OFFICE OF THE ATTORNEY GENERAL, <http://goo.gl/OOYEEy> (last visited July 17, 2015).

³⁴ *Delivery System Reform Incentive Payment Program*, HEALTH.NY.GOV, <https://goo.gl/YBN8fp> (last visited July 17, 2015).

providers as benchmarks are tied to clinical management and public health indicators.³⁵ As part of this program, providers may apply for Certificates of Public Advantage (“COPA”), allowing provider entities, including competitors, to enter into collaborative agreements under active state supervision granting the parties state action immunity.³⁶ To date, three different New York providers entities have submitted COPA applications for the DSRIP program.³⁷

In response to these providers seeking state action immunity for participation in the DSRIP program, the Commission authored a letter to the State of New York. In the letter, the Commission noted that COPA applications were unnecessary as pro-competitive collaborations, particularly those between healthcare providers, are embraced by the antitrust laws.³⁸ The Commission believes that COPA, and potentially other healthcare provider antitrust immunity laws, could “encourage healthcare providers to share competitively sensitive information and engage in joint negotiations with payers in ways that will not yield efficiencies or benefit consumers.”³⁹

With different states using very different tactics, merging provider parties must be aware of the additional level of scrutiny that awaits them outside of the traditional antitrust regime.

V. HEALTH INSURANCE MERGERS: BUYING POWER ENHANCED

Lastly, while this article focuses on trends within health provider merger antitrust, we would be remiss to not mention consolidation within the buyer side of the market and its potential impact on providers—i.e. the recent news of major health insurance mergers. To date, Aetna has made an offer to purchase Humana while Anthem is discussing a merger with Cigna.⁴⁰ If these deals were to be consummated, the American public and providers would be left with three dominant insurers nationwide.⁴¹ There would also likely be significant and lengthy review by the Department of Justice’s Antitrust Division (“Division”) for each transaction. In recent insurance mergers matters, the Division has utilized consent decrees requiring only that the parties divest significantly concentrated overlapping assets.⁴²

Unlike past deals, these potential mergers involve the nation’s largest insurers. A combination of these entities would create insurers with significant buying power and the ability

³⁵ *Id.*

³⁶ *Certificate of Public Advantage*, HEALTH.NY.GOV, <http://goo.gl/8MaICT> (last visited July 17, 2015).

³⁷ Letter from Marina Lao, Director, Office of Policy Planning Fed. Trade Comm’n, to New York State Department of Health (Apr. 22, 2015), available at <https://goo.gl/0Xtf42>.

³⁸ *Id.* at 1.

³⁹ *Id.* at 2.

⁴⁰ Reed Abelson, *With Merging of Insurers, Questions for Patients About Costs and Innovation*, N.Y. TIMES (July 5, 2015), <http://goo.gl/NPp38y>.

⁴¹ Brent Kendall and Anna Wilde Mathews, *DOJ Girds for Strict Review of Any Health-Insurer Mergers*, WALL ST. J. (June 28, 2015 5:13 PM), <http://goo.gl/q1P3Ay>.

⁴² See Complaint, *United States v. Humana, Inc.*, No. 1:12-cv-00464 (D.D.C. March 27, 2012) (Divestitures of Medicare Advantage plans in five states and in 45 counties); see also Press Release, Dep’t of Justice, *Amerigroup Corp.’s Divestiture of Its Virginia Operations Addresses Department of Justice’s Concerns with Wellpoint Inc.’s Proposed Acquisition of Amerigroup* (Nov. 28, 2012), available at <http://goo.gl/5npDzs> (requiring Amerigroup divest its Medicaid managed care plans in Northern Virginia).

to limit provider pay.⁴³ However, the merging parties could argue that increased insurer consolidation could be beneficial as a counterbalance and enable insurers to reduce provider reimbursement.⁴⁴

Such an argument would be misguided and would be unlikely to gain traction before the Division or the courts. If an insurer secures market power from an acquisition, there is no reason to assume that lower provider reimbursement will be reflected in lower premiums.⁴⁵ Moreover, a remedy involving divestitures, even of significant assets, may not alleviate antitrust concerns within health insurance markets, specifically those from provider groups.

VI. CONCLUSION

With increased attention from both state and federal regulators, as well new challenges from remedies and regulations to insurer consolidation, healthcare providers seeking acquisitions and mergers face new and ever-increasing challenges. Healthcare provider merger antitrust is a fluid field with constantly changing dynamics. Providers considering a merger should be well aware of all potential pitfalls prior to agreeing to terms.

⁴³ See generally Thomas Greaney, *Examining Implications Of Health Insurance Mergers*, HEALTH AFFS. BLOG (July 16, 2015), <http://goo.gl/ETT1DB> (noting that “enhanced market power” may allow the firms to reduce payment to physicians).

⁴⁴ *Id.*

⁴⁵ See David Lazarus, *As health insurers merge, consumers’ premiums likely to rise*, L.A. TIMES (July 10, 2015 4:00 AM), <http://goo.gl/nF7HRS> (noting lower reimbursement offerings to providers will not produce reduced premiums for consumers).



CPI Antitrust Chronicle

July 2015 (2)

Arbitrariness in the Imposition
of Penalties by the Competition
Commission of India:
The Need for Penalty Guidelines

Ananya Gaur

Arbitrariness in the Imposition of Penalties by the Competition Commission of India: The Need for Penalty Guidelines

Ananya Gaur ¹

I. INTRODUCTION

Penalties/fines are an important element of a competition jurisdiction's toolkit, even when criminal sanctions are present. The purpose of imposing penalties is generally either deterrence or retribution.² They may play a critical role in deterring anticompetitive conduct particularly in countries with limited personal liability for participating in a cartel, lack of prison terms for cartel organizers, and/or limited ability of affected third parties to collect damages.³ They may also act as an instrument for society to publicly express denunciation of an action as being wrong, besides educating the public at large that it is not an acceptable behavior under the law. Globally, over the last 25 years, the size of penalties/fines for competition law violations has increased substantially.⁴

Penalties are a deterrent because the possibility of a penalty enters into the calculus of enterprises considering violating the law. Competition authorities commonly face the challenge of how to ensure that penalties have a true deterrent effect. On the one hand, they should be large enough to ensure that the expected penalty for a violation is greater than the gain. The expected cost of punishment depends critically on the value of the penalty reduced for the probability of paying the fine, based on both detection and ultimate determination of a legal violation meriting that penalty. On the other hand, over-deterrence cannot be overlooked because many enterprises subject to penalty could face financial difficulties, which would be an economic policy concern if they reduced the number of competitors, the vigor of competition, or had substantial negative social and economic consequences.⁵

It is imperative that there be a certain basis for determination of penalties with the link between penalties and conduct being visible. The need for this is twofold—first, it will force the businesses to do a cost benefit analysis before violating the law; and second, it will reduce scope for arbitrariness as there will be less discretion in terms of determining the quantum of penalties, thus providing a much-required certainty to the law. This article discusses penalties imposed by the Competition Commission of India, the lack of objective criterion underlying them, and argues for the need for penalty guidelines towards the goals of deterring and punishing competition law violations.

¹ Ananya Gaur has recently graduated from National Law School University of India ("NLSUI"), Bangalore.

² H.L.A. HART, PUNISHMENT AND RESPONSIBILITY, 236 (1968).

³ OECD, *Criteria for Setting Fines for Competition Law Infringements*, Background paper, Latin American Competition Forum, 28-Aug-2013, at 7 (2013), available at DAF/COMP/LACF (2013)4/REV1.

⁴ *Id.*, at 5.

⁵ *Id.*, at 6.

II. IMPOSITION OF PENALTIES BY CCI

There are no criminal provisions in the Competition Act 2002⁶ (“Act”), but the Act empowers the Competition Commission of India (“CCI”) to impose substantial penalties for infringement of sections 3 (prohibiting anticompetitive agreements) & 4 (prohibiting abuse of dominant position) of the Competition Act. As per section 27 (b) of the Act, the CCI may impose such penalty upon the contravening parties, as it may deem fit, subject to a cap of 10 percent of turnover and, in case of cartels, three times of the profit of the erring enterprises.

Like most modern competition agencies, the CCI has a leniency program⁷ called the “Lesser Penalty” program, whereby an enterprise meeting certain conditions can provide evidence of an infringement, cooperate, and have a reduced/nil penalty. The CCI has wide discretion in imposing penalties as there are no guidelines other than the need to observe upper limits on penalty imposition as provided in the Act. However, discretion cannot be absolute or arbitrary and has to be exercised in a fair and reasonable manner.

The CCI has completed six years of active enforcement in May 2015 and established a reputation as a fair and impartial competition regulator. It has imposed penalties in several cases across a wide range of sectors such as real estate, pharmaceutical, stock exchange, coal, sports, entertainment, software, finance, etc. Initially, the CCI appeared a bit hesitant to impose stringent penalties but, gradually, it has started levying relatively higher penalties ranging up to 10 percent of the turnover of the erring enterprises. However, often the CCI’s orders say nothing about how it decides to levy different levels of penalty in various cases. To illustrate, penalties imposed by the CCI in key cases are briefly discussed below:

A. Cartel Cases

World over, cartels are considered the most serious violations of competition law and, therefore, the harshest penalties are generally imposed upon cartel members, and the Indian Competition law presents no exception. However, in the case of *Multiplex Association of India v. United Producers*⁸ as well as *Uniglobe Mod Travels Pvt. Limited v. Travel Agents’ Association of India*,⁹ a fine of only about INR¹⁰ 0.10 million each was imposed on the cartel members. The imposition of what can only be called “symbolic” penalties by the CCI in these cases goes against the commonly accepted view that cartelization, being one of the most serious offenses, should be punished heavily.

And in a ruling on cement cartels,¹¹ using the profitability benchmark for the first time, the CCI imposed a collective penalty of more than INR 60 billion on several cement manufacturers at the rate of 0.5 times of their profits—way below the benchmark of three times

⁶ Available at <http://www.cci.gov.in>.

⁷ The Competition Commission (Lesser Penalties) Regulations, 2009 available at <http://www.cci.gov.in>.

⁸ *Multiplex Association of India v. United Producers*, 01/2009, Order dated 25.05.2011.

⁹ *Uniglobe Mod Travels Pvt. Limited v. Travel Agents’ Association of India*, 03/2009, Order dated 04.10.2011.

¹⁰ INR refers to Indian Rupees.

¹¹ *Builders Association of India v Cement Manufacturers Association of India & Ors*, 29/2010, Order dated 20.06.2012.

of profit provided under the Act. It is noteworthy that cement cartels have been heavily penalized by many competition authorities world over.¹²

In other instances, in *suo moto case against aluminium phosphide tablets manufacturers*,¹³ the CCI imposed a penalty at nine percent of turnover on the grounds of price-fixing. The CCI imposed penalties ranging from eight-to-ten percent of their receipts (proxy for turnover) in several cases against chemist and drug associations in various parts of country for price-fixing and controlling the market.¹⁴ These penalties have been criticized for being grossly inadequate (as the receipts largely comprised their membership fees only), and not being levied on the turnover of the members constituting the association.¹⁵

In all these cases, the basis for penalty imposition was not discussed.

B. Abuse of Dominance Cases

The CCI has imposed penalties for abuse of dominance in many cases. Some of the landmark cases are *MCX Stock Exchange v. NSE and Others*,¹⁶ *Kapoor Glass Private Limited vs. Schott Glass Private Limited*,¹⁷ *Belaire Owner's Association v. DLF Limited*,¹⁸ *Surinder Singh Barmi v Board of Control of for Cricket in India*,¹⁹ and *Maharashtra State Power Generation Company Ltd. V. Coal India Ltd*,²⁰ in which the CCI imposed penalties of five percent, four percent, seven percent, six percent, and three percent of turnover respectively. However, there was practically no discussion about the basis of imposition of different levels of penalty for the same violation, i.e. abuse of dominance.²¹

In the case of *Ramakant Kini v. Hiranandani Hospital Mumbai*,²² the CCI held that maternity services, being a part of the overall services provided by the hospital, provided a “mitigating factor” and imposed only four percent of the turnover as penalty. In the case of *Shamsher Kataria v. Honda Siel & Others*,²³ the Commission penalized 14 Car Companies for abuse of dominant position²⁴ at two percent of their turnover after briefly touching upon some aggravating and mitigating factors.

¹² Mehta Pradeep, *Need for a realistic penalty regime*, FIN. EXPRESS (March 29, 2013).

¹³ Case 02/2011. Order dated 23/04/2012.

¹⁴ For example, *Santuka Associates Pvt. Ltd v. All India Organisation of Chemists and Druggists, (AIOCD)*, 20/2011, Order dated 19.02.2013 and *Rohit Medical Store v Macleods Pharmaceuticals Limited*, 78/2012, Order dated 29/01/2015.

¹⁵ Mehta Pradeep, *Need for a realistic penalty regime*, FIN. EXPRESS (March 29, 2013).

¹⁶ *MCX Stock Exchange v. NSE and Others*, 13/2009, Order dated 23.06.2011.

¹⁷ *Kapoor Glass Private Limited v. Schott Glass India Private Limited*, 22/2010, Order dated 29/03/2012.

¹⁸ *Belaire Owner's Association v. DLF Limited*, 19/2010. Order dated 03.01.2013. Penalty of INR 6.3 billion was imposed.

¹⁹ *Surinder Singh Barmi vs Board for Control of Cricket in India (BCCI)*, 61/2010, Order dated 08.02.2013.

²⁰ *Maharashtra State Power Generation Company Ltd. V. Coal India Ltd*, 03/2012. Order dated 09.12.2013.

²¹ Only in the BCCI order; the CCI stated that order was commensurate in view of BCCI's contribution to cricket in the country.

²² *Ramakant Kini v. Hiranandani Hospital*, 39/2012, Order dated 05/02/2014.

²³ *Shamsher Kataria v. Honda Siel & Others*, 3/2011, Order dated 25/08/2014.

²⁴ Also for violation of Section 3 (4) relating to vertical anticompetitive agreements.

Even though the CCI should be commended for discussing these factors (even though briefly) in these cases in the context of imposing penalties,²⁵ the question arises why such factors are not considered across the board, discussed, and applied appropriately.

III. PENALTY IMPOSITION IN KEY JURISDICTIONS (UNITED STATES AND EUROPEAN UNION): ROLE OF GUIDELINES

The question of how to set penalties/fines is one that many jurisdictions have addressed; the answers chosen affect incentives of both companies and their personnel to comply with competition law. Many jurisdictions across the world have developed transparent guidelines for fines after being questioned by the courts or facing widespread criticism. For instance, fine calculation in the European Union had been criticized as being vague and nebulous and compared to a lottery system; the European Union responded by introducing Guidelines on fines in 1998.²⁶

With more than 120 competition law jurisdictions, there are many ways in which penalty regimes can vary around the world. However, fining regimes in most jurisdictions are relatively transparent and predictable, yielding fines that are in some sense proportionate to the gravity of the infringement. Two jurisdictions dominant in terms of their effects on global commerce—the United States²⁷ and the European Union²⁸—calculate penalties according to a set of objective parameters with a view to providing strong deterrence. They follow a two-stage procedure comprising of: a) determination of a basic penalty reflecting the overall gravity of the offense, and b) adjusting it upwards or downwards after evaluating aggravating and mitigating factors. Many other jurisdictions have such guidelines with variations.²⁹ They prescribe a set of objective parameters to calculate penalties for the infringement of competition law.

Penalty guidelines form rules of practice from which the competition authorities/courts may generally not depart in an individual case without giving reasons that are compatible with the principles of equal treatment. These authorities exercise their discretion within the framework specified in the penalty guidelines and by taking account of mitigating and aggravating factors. Commonly applied aggravating factors include repeated infringement, ring leading/instigating/coercing, infringement continuing after the investigation, non-cooperation during investigation, and so on. Mitigating factors include effective cooperation, immediate termination of the infringement, acceptance of responsibility, limited participation, cooperation in the investigation, and so on. The guidelines provide transparency and some degree of predictability to the penalties, which may contribute both to the deterrence and desired behavior by the undertakings.

²⁵ The order doesn't explain how the arbitrary figure of two percent was arrived at.

²⁶ Mody Zia, *The Competition Commission of India's Approach to Penalties: The Need for Guidelines* (October 3, 2012), available at <http://xbma.org/forum/indian-update-the-competition-commission-ofindias-approach-to-penalties-the-need-for-guidelines/>.

²⁷ Penalty amount for violations under Section 1, Sherman Act is arrived at by referring to the United States Sentencing Guidelines Manual and the Antitrust Criminal Penalty Enhancement & Reform Act, 2004 ("ACPERA").

²⁸ Sentencing guidelines of 1998 were revised in 2006.

²⁹ *Setting of fines for Cartel in ICN Jurisdictions* by International Competition Network Cartel Working group, (April, 2008).

IV. NEED FOR PENALTY GUIDELINES FOR CCI

The discussion in section II indicates that there does not appear to be any logical pattern in the levy of penalties by the CCI, plus these do not seem to follow the global trend of penalizing cartels heavily, and they seem arbitrary. Generally, there is a lack of any discussion on how the penalties have been arrived at, thereby leaving no grounds for challenging the order except for arbitrariness. Only recently, in some of their orders, has the CCI briefly discussed factors influencing the imposition of penalty, but without indicating how the specific figure of penalty has been calculated.

In the absence of any guidelines, businesses have to fall back on orders previously passed by the CCI. However, even in similar cases, penalty decisions may be different, underlining the lack of objective criterion in their calculation. A broad assertion by the CCI that the penalties have been fixed taking into account the facts and circumstances of the case cannot be said to meet the requirement of a fair and reasonable exercise of discretionary powers.³⁰ With predictable penalties, an enterprise knows in advance the likely penalty and hence the gravity of any illegal conduct. Uncertainty in the imposition of penalty by the CCI has left enterprises and legal experts confused. As discussed in section III, this is in contrast to the global trend of having well -defined transparent guidelines for imposing penalties and has been criticized by stakeholders and commentators.

An increasing body of research suggests that penalties may be inadequate to deter cartel conduct.³¹ However, the existence of substantial penalties may contribute to an instability of the cartel conduct by increasing the likelihood of leniency applications. In India, despite CCI's leniency regulations being in place for more than five years, there have been hardly any publicized instances of the use of the leniency provisions. One possible reason as to why leniency pleas have yet to gather momentum could be the significant discretion vested with the CCI in deciding whether to grant leniency to an applicant.

However, the lack of leniency pleas may also be grounded in cartel members simply considering the risk of detection being low, as well as the matrix of expected profits vis-a-vis penalties to be imposed being attractive due to low penalties imposed by the CCI in cartel cases. This may be indicative of the relative ineffectiveness of penalties imposed in cartel cases in India. Effective amnesty /leniency programs have played a big role in increased cartel enforcement in EU, U.S., and other jurisdictions.

Enterprises and individuals are not deterred from participating in cartel activities unless the potential penalties for engaging in cartels outweigh the potential awards. Thus, in term of a "carrot and stick" approach, the likely heavy penalties work as the "stick" while the opportunity to avoid the sanction by coming forward and co-operating means the "carrot" If the CCI is not able to impose heavy penalties on cartels as provided in the Act in an objective manner, it would be difficult to fulfill the objective of curbing the menace of cartels in India.

³⁰ Zia, *supra* note 26.

³¹ OECD, *supra* note 3 at 6.

The current approach of penalty imposition by the CCI may perhaps end up defeating the purpose of why the Competition Act provides for levying penalties.³² First, a lack of guiding principles for quantifying the penalty amount may lead to arbitrary penalties. Second, orders that impose high penalties and do not contain a description of how the penalty amount has been determined are bound to be litigated before the COMPAT or the Supreme Court of India. Third, if the penalty is not commensurate with the magnitude of the offense, it would not have the desired deterrent effect. However, it should be noted that an excessive and disproportionate levy of penalty may end up providing undue and unfair advantage to the infringing parties' competitors. In the long-run, such penalizing practices may prove ineffective or chill competition rather than protect and promote competition.

The CCI's orders have also been criticized by the Competition Appellate Tribunal ("COMPAT") before which CCI's decisions are challenged. In the *Aluminium Phosphides Tablets*³³ case, while upholding the CCI's decision regarding contravention, the COMPAT came down heavily on the CCI and stated that "Time and again we have been reiterating the necessity of the [CCI providing] reasons while ordering the penalty," COMPAT further stated, "There can be no dispute that where harsh financial penalties are inflicted, the reasons become all the more necessary." The COMPAT advised CCI³⁴ to look at the factors such as financial health of the company, the necessity of the product, the likelihood of the company being closed down due to a harsh penalty, and the general reputation of the company.

In the *LPG cylinder* case,³⁵ the COMPAT upheld the CCI's order³⁶ about violation but noted, "We also do not find any reason why the CCI has chosen to inflict the penalty at 7%." COMPAT further noted, "In the absence of reason, the discretion tends to become arbitrary" and returned the matter back to CCI to re-determine the penalties.

Further, while COMPAT has been accepting appeals and applications for interim stays, it is doing so on the precondition of payment of a significant portion of the penalty amount.³⁷ Going a step further, last year the Supreme Court directed DLF, a real estate player, to deposit the full amount of the INR 6.3 billion penalty imposed by CCI for the duration of the appeal proceedings. Given COMPAT's reluctance to grant an unconditional stay on the payment of penalty, the Supreme Court's order to deposit the entire penalty during the process of appeal has brought to the fore the issue of penalty imposition using objective parameters.

When questioned in a TV interview on February 18, 2013, Ashok Chawla, Chairman, CCI, stated,³⁸ "We have taken a conscious decision to build on some more cases before

³² Zia, *supra* note 26.

³³ Order of COMPAT in Appeal no. 79 of 2012 against the order dated 23.4.2012 passed by the CCI in Case No. 2/2011, p47.

³⁴ *Id.*, at 50.

³⁵ Suo-moto case against LPG Cylinder Manufacturers, 03/2011.

³⁶ COMPAT order dated 20.12.2013, *available at* http://compat.nic.in/upload/PDFs/decordersApp2013/20_12_13.pdf.

³⁷ May be in the 10 to 25 percent range.

³⁸ Competition Commission of India Chairperson Ashok Chawla on CNBC-TV18, *available at* http://www.moneycontrol.com/news/business/will-formulate-transparent-penalty-system-soon-cci_827151.html.

establishing an architecture that will ensure transparency in the broad principles or guidelines for imposition of penalty.” However, the analysis above brings out the dire need for penalty guidelines in the Indian competition law regime, which should spell out why and how the CCI arrives at the quantum of penalty and the premise for the exercise of its discretion.

With somewhat predictable penalties, an enterprise will know in advance the likely penalties and hence the gravity of its action before committing any anticompetitive conduct. Further, some degree of predictability of penalties may be essential to provide appropriate incentives for enterprises to cooperate with the authorities³⁹ as the estimated penalty is a key factor in their cooperation decision. Therefore, it is high time that the CCI bring its penalizing practices in line with its mandate of deterring anticompetitive practices.

V. PROPOSED PENALTY GUIDELINES FOR CCI

The above section has demonstrated a dire need for CCI to adopt penalty guidelines for efficient competition enforcement. Speaking at an international conference organized by the American Bar Association at Delhi on November 30, 2012, Ashok Chawla, Chairman, CCI, stated⁴⁰ that the CCI has the “last mover advantage.” This implies that one can learn and adapt from experiences and practices followed in other jurisdictions, rather than create them from one’s own experience.⁴¹ It is high time that CCI looks at penalty guidelines of other jurisdictions such as European Union and adopts what is suitable in view of the provisions of Indian competition law and other relevant factors. These guidelines should, *inter-alia*, address the following issues:

A. Relationship Between Penalties and Conduct

This relationship should be clearly visible and penalties should be proportionate to the severity of infringement. COMPAT has also emphasized⁴², “...there should be proportionality in the award of penalty ... Supreme Court has time and again relied on the doctrine of proportionality while at the same time emphasizing on the aspect of deterrence.” The guidelines should also allow for predictability (knowing in advance the gravity of unlawful conduct and the likely penalty) in order to enhance deterrence effect as well as promote leniency applications before CCI.

B. Basis of Calculation of Base Penalties

The term “turnover” is of great significance for the imposition of a penalty under section 27(b) and its interpretation is essential as to whether it means turnover of relevant product in the relevant market or the whole turnover of the company. The term “turnover” under section 2(y) of the Act includes “value of sale of goods or services” and it has not been correlated anywhere in the Act with “relevant market” or “relevant geographic market.” Therefore, the legislative intention of the term “turnover” defined in u/s 2(y) requires the literal meaning, i.e. the turnover

³⁹ International Competition Network Cartel Working group (2008), *Setting of fines for Cartel in ICN Jurisdictions*, available at <http://www.internationalcompetitionnetwork.org/uploads/library/doc351.pdf>.

⁴⁰ Pradeep, *supra* note 12.

⁴¹ *Id.*

⁴² P. 50 of the COMPAT order in Aluminium Phosphide Tablets case.

recorded in the financial books of a person or enterprise or a member of cartel is the turnover on which the penalty u/s 27(b) is to be calculated.

Accordingly, the CCI has based its penalty calculation on total turnover of the infringing parties in its various orders, which has evoked criticism. For example, the order against the Cricket Control Board has been criticized on the ground that the penalty should have been imposed on the revenues earned from the IPL tournament rather than the BCCI's total turnover.

In its landmark judgment in the *Aluminium Phosphides Tablets*⁴³ case, the COMPAT stated that while deciding penalties, the CCI should consider the relevant turnover, i.e., turnover of only the product involved in the infringement; not the turnover of the entire multi-product enterprise. The Commission has challenged the COMPAT decision in the Supreme Court of India as the relevant product is not defined in the Act.

The Indian Act provision of imposing a penalty up to 10 percent of total turnover is similar to the 10 percent of total turnover provided in the European Union and the United Kingdom. These jurisdictions use turnover of the commerce affected by the infringement for determining base penalties and then use mitigating and aggravating factors to adjust the penalty; the final figure is then subject to a cap of 10 percent of total turnover. The CCI may also consider addressing the issue of using the appropriate form of turnover for penalty determination by adopting a similar approach and developing penalty guidelines based on relevant turnover as well as other factors subject to penalty being limited to 10 percent of total turnover.

C. Aggravating and Mitigating Factors

The guidelines should also incorporate aggravating factors to increase the penalties as well as mitigating factors to reduce penalties. The COMPAT has also emphasized this aspect in its orders⁴⁴ and suggested that, in this regard, EU and OFT⁴⁵ Guidelines would be relevant. These factors have been briefly discussed in the section IV above.

The CCI could consider adopting additional aggravating and mitigating factors. For example, competition compliance may be used as a mitigating factor.⁴⁶ Many jurisdictions such as France⁴⁷ reduce penalties keeping in view the quality of a competition compliance program, a major instrument at the disposal of companies to prevent competition law infringements. As compliance programs are costly, to incentivize companies to invest in them the guidelines in India could include the existence of a "robust" compliance program as a mitigating factor.

⁴³ Case No. 2 of 2011.

⁴⁴ P. 50, COMPAT order in Aluminium Phosphide Tablets case as well as p. 62, COMPAT order in LPG Cylinders Case dated 20.12.2013.

⁴⁵ Office of Fair Trading, United Kingdom.

⁴⁶ Due to lack of clarity on their role as a mitigating factor in penalty imposition, and in view of high costs involved in developing the compliance programs, Indian corporates have been less than enthusiastic for compliance programs.

⁴⁷ The United States does not use it as a mitigating factor although it is provided in its guidelines. The European Union does not provide for competition compliance as a mitigating factor, but various commentators recommend its use as a mitigating factor.

The logic here is that Commission should be a watchdog, not a bloodhound; and should nudge companies towards compliance. This would link the advocacy and enforcement aspects of CCI's functions. This would also help companies minimize the possibility of committing infringements, reduce costs/negative effects of regulatory intervention and litigation, and avoid/mitigate the potential penalties. This was also recommended by the Confederation of Indian Industries ("CII") as part of its suggestions to the parliamentary standing committee on finance.

As it may not be clear to everyone what a "robust" compliance program⁴⁸ is, the Commission may adopt guidelines or at least some form of guidance on the measures that undertakings need to put in place for their compliance to be taken into account as a mitigating circumstance.⁴⁹

Keeping in view the above, like many jurisdictions the CCI may consider using a four-step process for setting the penalties for competition law infringement: 1) set the base penalty; 2) adjust the base penalty in light of aggravating or mitigating circumstance; 3) apply the cap as provided in the competition law to the resulting overall penalty; and 4) reduce or eliminate the penalty to account for a leniency application if any.

VI. CONCLUSION

Global experience indicates that imposition of penalties using a set of objective parameters is important for efficient competition law enforcement. The level of a penalty needs to be sufficiently high both to punish the enterprises involved and to deter others from practices that infringe the competition law. Although Indian competition law has been heavily inspired by the jurisprudence developed in the European Union and the United States, there is a surprising and inexplicable lack of such inspiration when it comes to determining penalties. This article has demonstrated how penalties imposed by the CCI are perceived as arbitrary and lacking a cogent framework for quantifying them; and argued for adoption of guidelines possibly on similar lines as in many other jurisdictions.

The COMPAT has also, time and again, emphasized the need to develop the guidelines for penalty imposition. Now that cases have started going to Supreme Court, the highest court in India, it is likely that very soon the Supreme Court may also start pointing this problem out in its orders. Therefore, it is vital that the CCI adopts clear and objective guidelines for penalty imposition at the earliest.

Predictable and transparent penalty regime may increase deterrence and promote leniency applications before the CCI. Further, having clear guidelines will help reduce the uncertainty and arbitrariness of penalties imposed, as well as lead to development of jurisprudence by providing scope for discussion on the factors relevant for determining the quantum of penalty. This will not only provide comfort to businesses by making the penalty regime relatively objective and predictable but also help CCI to emerge as an effective and

⁴⁸ J. Murphy & W. Kolasky, *The Role of Anti-Cartel Compliance Programs in Preventing Cartel Behavior*, 26(2) ANTITRUST, (Spring 2012). They suggest 20 features that an effective compliance program should have.

⁴⁹ Damien Geraldin, *Discussion Paper on the EU Competition Law Fining System: A Reassessment*, p. 25 (2011), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1937582.

credible regulator. In the long run, this will promote effective enforcement and competition compliance and help in the development of competitive markets in India with positive impacts on consumer welfare and economic growth.

CPI Antitrust Chronicle

July 2015 (2)

An Overview of the NDRC Decision in the *Qualcomm* Investigation

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An Overview of the NDRC Decision in the *Qualcomm* Investigation

H. Stephen Harris, Jr.¹

On February 10, 2015, the National Development and Reform Commission (“NDRC”) of China issued its Administrative Penalty Decision (the “Decision”) pursuant to Article 47 of the China Anti-Monopoly Law (“AML”), based on its investigation of possible abuses of dominance by Qualcomm Incorporated (“Qualcomm”). Though not the first abuse of dominance investigation conducted by one of the Anti-Monopoly Enforcement Authorities (“AMEAs”), the NDRC’s Decision marks the first instance in which an AMEA has found a violation of the abuse of dominance provisions of Chapter 3 of the AML.²

The investigation, which began sixteen months earlier, in November, 2013, focused on “suspected abuses of dominance,” in violation of Chapter III of the AML, in two markets defined by NDRC as: (1) the licensing market for standard essential patents (“SEPs”)³ for CDMA, WCDMA, and LTE wireless communications (the “SEP licensing market”); and (2) the market for sales of baseband chips⁴ for CDMA, WCDMA, and LTE wireless communications (the “baseband chip market”).

In defining the SEP licensing market, the NDRC found that, because Qualcomm had entered into “package licensing” (i.e., offered portfolio licenses) of its SEPs, the relevant product market for SEPs in the case should be defined as “a collection of every independent licensing market of SEPs held by Qualcomm.” Because patent licensing, exploitation, and protection have an “attribute of territoriality,” the NDRC concluded that the relevant geographic market was “a collection of countries or regions where Qualcomm has SEPs.”

The NDRC defined three separate baseband chip markets: the markets for CDMA, WCDMA, and LTE chips, respectively. Because chipmakers sell the chips throughout the world and compete globally, and smartphone manufacturers buy the chips worldwide, the agency found that the geographic market for each of these chip markets was global.

NDRC next considered whether Qualcomm held a dominant position in these defined relevant markets. Article 19(1) of the AML provides that a company can be presumed to have a dominant market position if its market share accounts for more than 50 percent of the relevant

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² Instead the other decisions of the NDRC and SAIC to date found violations of the provisions governing so-called “monopoly agreements” in chapter 2 of the AML, primarily price-fixing agreements between competitors and resale price maintenance arrangements between manufacturers and distributors.

³ A standard-essential patent is a patent that claims an invention that must be used to implement a technical standard.

⁴ Baseband chips, or baseband radio processors, are an integrated circuit that manages all the radio functions of wireless communications devices, the relevant types of which in this matter were 3G and 4G smartphones.

market. The NDRC found that Qualcomm held a 100 percent market share in every licensing market where it owned SEPs and that there was no competition in that SEP licensing market.⁵ Accordingly, the NDRC presumed that Qualcomm was in a dominant position in the SEP licensing market.

The NDRC then considered various relevant factors set forth in Article 18 of the AML to determine whether a company had a dominant position. On the basis of certain of those factors, the agency found that Qualcomm had a dominant market position in the SEP licensing market, based on the following findings:

1. Qualcomm controlled this market because manufacturers could not produce 3G and 4G smartphones without risking Qualcomm's initiating patent infringement lawsuits or seeking injunctions;
2. Smartphones manufacturers are highly reliant on Qualcomm's SEP portfolio, because each 3G and 4G SEP is indispensable and irreplaceable for such manufacturers; and
3. Entry into the market is difficult because, once a patent is incorporated into a standard, competing technologies are excluded from such standards, and switching to an alternative standard involves unbearable costs.

Article 19 of the AML permits companies to prove that they are not dominant, but the Decision expressly found that Qualcomm did not provide evidence sufficient to prove that it was not in a dominant position in the SEP licensing market. On these grounds, the NDRC concluded that Qualcomm was dominant in this market.

The NDRC then moved to consideration of whether Qualcomm was dominant in the CDMA, WCDMA, and LTE baseband chip markets. Based on an industry report, the NDRC concluded that Qualcomm's market shares in these markets each exceeded 50 percent, giving rise to a presumption of dominance under Article 19.

Moving to the factors for the assessment of dominance in Article 18, the agency found that: (1) Qualcomm had a relatively high ability to control this market, because, *inter alia*, Qualcomm's products are much more competitive than competing products; (2) major smartphone manufacturers are highly dependent on Qualcomm's chips, because they have limited options from a small number of suppliers and because Qualcomm excels in the middle-level and high-end baseband chip technologies, product functions, and brand, thus leading many device makers to select Qualcomm chips to gain more competitive advantages for their products; and (3) the R&D investment requirements to participate in this technology-intensive market makes entry difficult. On these grounds, and because Qualcomm did not provide evidence proving that it was not dominant, the NDRC concluded that Qualcomm was dominant in all three baseband chip markets (CDMA, WCDMA, and LTE).

⁵ The identical presumption is set forth in article 19(1) in the NDRC Anti-Price Monopoly Rules that were put into effect as of Feb. 1, 2011. For an English translation of same, see H. STEPHEN HARRIS, JR. ET AL., ANTI-MONOPOLY LAW AND PRACTICE IN CHINA, Annex at 450 (2011).

Having defined the relevant markets, and having found Qualcomm to be dominant in all of them, NDRC next set forth its specific findings of Qualcomm's conduct that NDRC found to constitute abuses of dominance in violation of the AML. Specifically, the NDRC found that:

1. Qualcomm violated Article 17, paragraph 1, subparagraph 1 of the AML⁶ by charging unfairly high royalties for its SEPs, because: (1) Qualcomm included some expired CDMA SEPs in its licensing agreements and failed to prove that the expired SEPs equaled the value of patents that were newly added to the portfolio during the term of the license; (2) Qualcomm failed to provide patent lists to licensees, and set a constant long-term royalty rate, thus including expired patents in the licensed portfolio with licensees having no opportunity to avoid paying for expired patents through fair negotiations; (3) Qualcomm required some licensees to grant back their patents on a royalty-free basis, and asked some to waive their litigation rights over their patents against Qualcomm and Qualcomm's customers; and (4) the portfolio licensed by Qualcomm included non-SEPs for wireless communications, in addition to SEPs, resulting in charging excessive and unfairly high royalties to any licensees that were "forced" to accept the packaged patent licenses, the royalty rates of which were based on the wholesale net selling prices of smartphones.
2. Qualcomm violated Article 17, paragraph 1, subparagraph 5 of the AML⁷ by bundling the sale of non-SEPs with SEPs, without reasonable justification, without offering licensees a choice to acquire licenses for only SEPs.
3. Qualcomm violated Article 1, paragraph 1, subparagraph 5 of the AML⁸ by conditioning the sale of baseband chips on the purchasers' agreement to sign a license agreement with unreasonable provisions, such as charging for expired patents, royalty-free grant-back licensees, the bundled sale of SEPs and non-SEPs, and the purchasers' agreement not to challenge the agreement, as well as by Qualcomm's practice of stopping its supply of baseband chips to licensees that initiated litigation against Qualcomm.

Based on these three findings of AML violations, the NDRC set out its Administrative Penalty Decision pursuant to Articles 47 and 49 of the AML⁹ and proceeded to order Qualcomm to cease its illegal abuses of dominance. Specifically, the NDRC ordered that Qualcomm take, or refrain from taking, the following actions:

⁶ This provision states that "Undertakings with dominant market positions are prohibited from engaging in any of the following conducts that abuse their dominant market positions: (1) Selling products at unfairly high prices or buying products at unfairly low prices."

⁷ This provision reads: "Undertakings with dominant market positions are prohibited from engaging in any of the following conducts that abuse their dominant market positions: (5) Without valid justification, tying in products or imposing other unreasonable trading conditions."

⁸ *Id.*

⁹ Article 47 reads as follows: "Where undertakings abuse their dominant market positions in violation of the relevant positions of this law, the AMEA shall order the undertakings concerned to cease and desist such acts, confiscate the illegal gains, and impose a fine of more than 1% but less than 10% of the total turnover of the undertaking in the previous year." Article 49 states: "Where determination of the amount of fines pursuant to Article 46, Article 47 and Article 48, the AMEA should consider factors such as the nature, seriousness and duration of the illegal act."

1. Provide patent lists to parties seeking licenses to its SEPs for manufacturers of smartphones in China, and not charge for expired patents;
2. Not require royalty-free grant-back licenses of the licensees' non-SEPs against the will of manufacturers of smartphones in China;
3. Not force licensees to grant back patents without reasonable consideration;
4. Not use a royalty base of the entire wholesale net selling price of the device while also adopting a relatively high royalty rate, for smartphones sold for use within China;¹⁰
5. Refrain from bundling the sale of non-SEPs with SEPs in licenses to smartphone manufacturers in China, without reasonable causes; and
6. Refrain from imposing unfair conditions on the sale of baseband chips to smartphone manufacturers in China—such as requiring potential licensees to pay for expired patents, agree to royalty-free grant-back licenses, bundling SEPs with non-SEPs without reasonable causes, or conditioning the supply of chips on a licensee's agreement that it would not challenge the license agreement.

The NDRC then proceeded to impose a fine of 8 percent of Qualcomm's annual revenue within the territory of China for 2013.

Shortly after release of the Decision, Qualcomm announced that it would not pursue further legal proceedings contesting the NDRC's findings, and agreed to implement a rectification plan to modify certain of its business practices in China that Qualcomm stated satisfied the requirements of the NDRC order, and had been accepted by NDRC.¹¹ The key terms of that rectification plan include the following:

1. Qualcomm will offer licenses to Chinese-issued SEPs separately from licenses to its other patents and will provide patent lists during the negotiating process;
2. Qualcomm will negotiate cross-licenses with Chinese licensees in good faith and provide fair compensation for such rights;
3. Qualcomm will charge royalties for 3G and 4G Chinese SEPs for branded smartphones sold for use in China based on a royalty base of 65 percent of the net selling price of the smartphone and royalty rates of 5 percent for 3G devices and 3.5 percent for 4G phones;
4. Qualcomm will provide existing licensees an opportunity to take the new terms for sales of branded devices for use in China as of January 1, 2015; and

¹⁰ The Decision does not define what would constitute a lawful royalty base or royalty rate. It thus stops short of imposing on Qualcomm a "compulsory license" with any specific rates or terms.

¹¹ See Qualcomm Press Release, *available at*:
http://files.shareholder.com/downloads/QCOM/3864235320x0x808060/382E59E5-B9AA-4D59-ABFF-BDFB9AB8F1E9/Qualcomm_and_China_NDRC_Resolution_final.pdf

5. Qualcomm will not condition the sale of baseband chips on the chip customer signing a license agreement with terms that the NDRC finds to be unreasonable, or on the customer agreeing not to challenge unreasonable terms in the license agreement.¹²

The specific details of the changes to Qualcomm's business practices that will take place in light of the Decision are therefore set out as voluntary commitments put forward by the company in its rectification plan, and were not ordered by the NDRC beyond the more general language in the Decision, as described above. The NDRC praised Qualcomm for cooperating in the investigation and for "proactively" proposing a "package of corrective measures," and went on to acknowledge that the "[c]orrective measures proposed by Qualcomm have met the NDRC's requirements."¹³

This landmark case provides much needed guidance on the approach the NDRC¹⁴ will take to analyzing complex issues at the intersection of antitrust and intellectual property law. However, in part because the Decision itself is drawn in broad terms, while the detailed obligations of the company are set out in a voluntary rectification plan that was acknowledged by the NDRC to meet its requirements, the Decision leaves open many questions about the NDRC's views of the scope of its own jurisdiction. For example, the precise limitation of the geographic scope of the remedies to smartphones made in China for use in China, and the limitation of the SEPs affecting only Chinese patents, are not set out in the Decision itself.

Also, the broad language in the Decision itself presents the troubling prospect of insoluble conflicts of law conundrums that could arise if antitrust authorities of multiple jurisdictions purport to impose inconsistent worldwide licensing obligations on patent holders without regard to, or in defiance of, the axiomatic "territorial nature" of IP rights.¹⁵

This is but one of the knotty issues facing us in the brave new world of numerous active antitrust regimes around the world that appear to have adopted differing views of the proper role of competition law in regulating IP licensing conduct. In light of these and other unknowns, and the worldwide nature of patent licensing in many sectors, the NDRC *Qualcomm* Decision may entail more questions than answers regarding future AML enforcement in matters affecting intellectual property rights.

¹² The Qualcomm rectification plan makes clear, however, that this commitment does not include a commitment that Qualcomm sell chips to any entity that is not a Qualcomm licensee, and does not apply to a chip customer that refuses to report its sales of licensed devices as required by the license agreement.

¹³ *China's NDRC fines Qualcomm 6.088 billion yuan, imposes remedies* (English version), MLEX (February 10, 2015).

¹⁴ NDRC decisions do not bind the other two AMEAs, the State Administration for Industry and Commerce (SAIC) and the Ministry of Commerce (MOFCOM), thus raising the prospect that the three agencies may apply the AML to IP rights in different ways. The SAIC recently issued its Rules on the Prohibition of Abusive Use of Intellectual Property Rights to Exclude or Restrict Competition, which, in turn, are not binding on the NDRC or MOFCOM.

¹⁵ See generally A. Peukert, *Territoriality and Extraterritoriality in Intellectual Property Law*, in BEYOND TERRITORIALITY: TRANSNATIONAL LEGAL AUTHORITY IN AN AGE OF GLOBALIZATION (G. Handl & J. Zekol, eds. 2011).

CPI Antitrust Chronicle

July 2015 (2)

The Future of African Antitrust Enforcement

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The Future of African Antitrust Enforcement

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An important legal development for global investors into Africa is the increasing enforcement of antitrust law by regional bodies like the Common Market for Eastern and Southern Africa (“Comesa”) as well as the East African Community (“EAC”) and the West African Economic and Monetary Union (“WAEMU”), alongside several powerful national competition authorities.

A number of powerful local antitrust authorities have established themselves over the last 10 years in Africa, including the South African Competition Commission (which has been in operation since 1999), the Fair Competition Commission of Tanzania (established in 2003) and the Zambian Competition and Consumer Protection Commission (previously the Zambia Competition Commission, established in 1997). These authorities have levied millions of dollars in fines on companies for anticompetitive practices like price-fixing, market allocation, bid-rigging and abuses of dominance, sometimes using dawn raids to obtain evidence and employing sophisticated software to search large volumes of electronic data.

These authorities have also energetically pursued companies who have implemented merger transactions without notifying them or have implemented mergers prior to clearance being obtained. Merger control is also actively enforced by competition regulators in countries like Namibia, Botswana, Swaziland, Mauritius, Kenya, Malawi, and Morocco.

However, in the last two years, we have witnessed the establishment of regional competition regulators who are tasked with enforcing merger control and investigating and prosecuting anticompetitive conduct alongside national authorities.

Comesa was established in 1994 to promote economic integration among 19 African member states in Central, Eastern, and Southern Africa, namely Burundi, Comoros, Democratic Republic of Congo, Djibouti, Egypt, Eritrea, Ethiopia, Kenya, Madagascar, Malawi, Mauritius, Namibia, Rwanda, Seychelles, Sudan, Swaziland, Uganda, Zambia, and Zimbabwe. The Comesa Competition Commission commenced regulation of mergers in January 2013 but, unfortunately, no minimum monetary thresholds for notification of merger transactions in Comesa were set and the regulations specified very high filing fees. The regulations were also unclear in various respects, not least of all on whether transactions with an impact in Comesa states that have their own national competition authorities, like Kenya and Zambia, were still required to be notified separately in those countries.

These factors negatively impacted compliance with the new regime—by the end of 2014, only 66 filings had been submitted (although this was an increase on the total in 2013, which was

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only 44). In March 2015, however, an amendment to Comesa's regulations clarified that a merger notification in Comesa is only required where:

1. both the acquiring firm and the target firm, or either the acquiring firm or the target firm, operate in two or more Comesa member states;
2. if the combined annual turnover or combined value of assets, whichever is higher, in Comesa of all parties to a merger equals or exceeds U.S. \$50,000,000; and
3. the annual turnover or value of assets, whichever is higher, in Comesa of each of at least two of the parties to a merger must equal or exceed U.S. \$10,000,000, unless each of the parties to a merger achieves at least two-thirds of its aggregate turnover or assets in Comesa within one and the same Comesa member state.

The maximum filing fee was also substantially reduced—the filing fee is now the higher of 0.1 percent of the combined annual turnover or combined asset value in Comesa, capped at a maximum of U.S. \$200,000.

In practice, it seems that most of the competition authorities in the Comesa member states now recognize that if a filing has been made with Comesa, no separate filings to any national authorities are required. The only exception is Kenya, where the competition authority, the Competition Authority of Kenya ("CAK") continues to insist on a local filing pending amendment of its national competition legislation.

In effect, this means that parties to cross-border transactions with an impact in the Comesa states can treat Comesa like a "one-stop-shop" and, further, it is sometimes cheaper to lodge a single Comesa filing than to file in several different jurisdictions (particularly those which charge relatively high filing fees). And, unlike with some local competition laws, the Comesa regulations do not require that parties await clearance before they can implement their merger, which means that the notification requirement need not hold up implementation of transactions.

Although Comesa's focus to date has been on merger reviews, it is likely that it will begin enforcing its regulations dealing with cartels and abusive practices by dominant firms in the near future, as it builds its capacity and expertise. This is already a focus for the African Competition Forum, a network of competition authorities in African countries that was formally launched in March 2011. It involves 41 out of 54 African countries, and aims to enhance the adoption of competition laws across the Continent and to build the capacity of new authorities. It has already published a number of papers on concentrated sectors of the African economy that have posed challenges for national competition authorities, like cement and poultry. This facilitates the sharing of expertise by more established competition authorities, like those in South Africa and Namibia, who have intensively investigated complaints about cartels and abuses of dominance in those sectors of the African economy.

The EAC is another regional African economic organization that has enacted antitrust regulations, although it is not yet fully operating. The EAC Secretariat is in the final stages of setting up the organizational structure of the EAC Competition Authority, which will regulate competition in the Republic of Burundi, Kenya, Rwanda, United Republic of Tanzania, and the Republic of Uganda. The authority is expected to come into force in or about August 2015. Notification of mergers will be mandatory, although the thresholds for filings and the applicable filing fees have not yet been published. It is unclear how this regime will interface with Comesa

and apply in states like Tanzania and Kenya (a Comesa member state) that have their own local authorities.

WAEMU (also known by its French acronym, UEMOA) was established by the Treaty of Dakar in 1994 and is composed of Bénin, Burkina Faso, Côte d'Ivoire, Guinée Bissau, Mali, Niger, Sénégal, and Togo. It adopted competition legislation in May 2002, which became operative from January 1, 2003. Notification of mergers is not compulsory, but its rules provide that if a proposed merger will result in an abuse of a dominant position, the WAEMU Commission can order the merging parties: (i) not to implement the transaction (if it has not been executed/closed) or to re-adopt the status they had before the transaction, (ii) to modify the transaction, or (iii) to take any necessary measure to ensure or re-establish sufficient competition. However, it is possible for parties to ask for the Commission's opinion before, or even after, a transaction is implemented.

These new regional antitrust regulators will play a valuable role in preventing anticompetitive conduct and concentrations which may result in a prevention or lessening of competition on the Continent—particularly in countries like the DRC, Djibouti, Eritrea, Libya, and Uganda that don't yet have a national competition authority. There is the potential for regional bodies to act as a cheaper and faster one-stop-shop for merger clearances and to build up significant economic and technical expertise, particularly in dealing with cartels and monopolies that impact cross-border trade.

Countries with insufficient resources may find it more effective to rely on antitrust enforcement by these regional authorities, than to establish their own national authorities. However, particularly in relation to merger control, there currently is no attempt to clarify the relationship between the national and the regional authorities, or between the various regional authorities. Kenya, for example, belongs to both the EAC and Comesa, and Tanzania has its own local competition authority and belongs to the EAC.

Far more co-ordination is required among these various African regulators in order to eliminate duplication of costs and effort—for the authorities themselves, and the companies they regulate. Much work is needed to harmonize the approach of these authorities to substantive issues (for example, what constitutes a merger) and procedural ones (for example, whether parties are entitled to implement a merger before clearance has been granted and what the maximum time periods for reviews are). Ideally, these new authorities should be co-ordinating their efforts to enhance competition in African markets through organizations like the African Competition Forum and the International Competition Network.

Foreign investment will be affected if parties wishing to acquire a business in Africa are forced into multiple filings in several jurisdictions, and face increased transaction costs and possible delays as a result. Uncertainty about the principles applied in reviewing mergers—for example, is the only relevant factor whether competition will be lessened, or does the authority also consider public interest factors like job losses or local investment—is also likely to impact on acquisitions on the Continent. Protracted and costly merger reviews may make Africa seem like a less attractive destination for investment.

CPI Antitrust Chronicle

July 2015 (2)

Section 5 Enforcement: Common Law Guidance

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Section 5 Enforcement: Common Law Guidance

Pete Levitas & Farrell Malone¹

I. INTRODUCTION

The proper scope of the U.S. Federal Trade Commission's ("FTC's") Section 5 enforcement authority has been a recurring issue in antitrust enforcement. In recent months there has been renewed attention to the issue of formal guidance on Section 5 enforcement, generated largely by FTC enforcement actions and related statements and speeches by FTC Commissioners. Given the views of the majority of the Commission, however, this most recent spike in attention seems unlikely to lead to any immediate formal written guidance.

Moreover, the discussion to date has mostly been focused on broad statements and general principles that do not yet reach the level of detailed guidance that would be most useful for companies potentially subject to Section 5 enforcement. Although companies and their counsel would welcome additional guidance from the Commission, for the foreseeable future, recent FTC enforcement actions are the best Section 5 "roadmap" available.

II. SCOPE OF SECTION 5

Section 5 of the Federal Trade Commission Act prohibits "[u]nfair methods of competition."² The FTC has jurisdiction to enforce the Clayton Act, and, through Section 5, the Sherman Act, but it is the FTC's use of Section 5 as a source of "standalone" enforcement authority that creates controversy.³ Section 5 grants the FTC power "to define and proscribe an unfair competitive practice" and bring an enforcement action to end such conduct.⁴ In *Brown Shoe*, the Supreme Court noted that the FTC's "broad power" to declare unlawful certain unfair business practices under Section 5 "is particularly well established with regard to trade practices which conflict with the basic policies of the Sherman and Clayton Acts *even though such practices may not actually violate these laws*" (emphasis added).⁵

Thus, for many years it has been accepted that standalone Section 5 authority extends beyond the bounds of the Sherman Act and the Clayton Act. Exactly how far beyond the bounds of the Sherman Act and the Clayton Act this standalone Section 5 authority extends is the question that engenders such uncertainty and dispute.⁶

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² 15 U.S.C. § 45; *see also* *FTC v. Ind. Fed'n of Dentists*, 476 U.S. 447, 454 (1986). Section 5 also proscribes "unfair and deceptive acts and practices," 15 U.S.C. § 45, although this provision is routinely used as part of consumer protection enforcement actions. This article will focus on unfair methods of competition and its use as the basis for standalone Section 5 enforcement.

³ 15 U.S.C. § 21(a) (Clayton Act Enforcement); 15 U.S.C. § 45 (Sherman Act); *see also* *FTC v. Ind. Fed'n of Dentists*, 476 U.S. 447, 454 (1986).

⁴ *See* *FTC v. Sperry & Hutchison Co.*, 405 U.S. 233, 244 (1972).

⁵ *FTC v. Brown Shoe Co.*, 384 U.S. 316, 321 (1966) (emphasis added).

⁶ *See* 15 U.S.C. § 45; *FTC v. Ind. Fed'n of Dentists*, 476 U.S. 447, 454 (1986).

Two factors have contributed to this ongoing debate. First, the FTC Act, much like the Sherman Act and the Clayton Act, provides only a very general standard and leaves significant room for interpretation. Second, unlike the Sherman Act and Clayton Act, there have been relatively few judicial decisions regarding the scope of Section 5 because there are few standalone Section 5 enforcement actions.

The FTC's recent use of Section 5—in particular in the standard-setting context—has led to renewed calls for the FTC to more clearly define the limits of its standalone Section 5 authority. However, no Commission majority has developed in support of formal written guidance, and it is more likely that the Commission will continue to rely on enforcement actions, and any decisions reviewing those enforcement actions, in lieu of formal guidance.

III. ENFORCEMENT GUIDELINES

As summarized in Table 1 below, the Commission is split on whether the FTC should issue Section 5 enforcement guidelines. Two current Commissioners (Commissioners Ohlhausen and Wright) are in favor of Section 5 guidelines. Those who advocate guidelines cite a number of reasons, most commonly and most importantly that the FTC has an obligation to formally define the parameters of standalone Section 5 authority, both to provide some limiting principle for enforcement and to offer the business community a clear, detailed explanation of how Section 5 will be applied, as distinct from the Sherman and Clayton Acts.⁷

Commissioner Wright has recently been active in advocating this position. He has made several speeches on the topic and in 2013 published a proposed policy statement regarding the proper use of standalone Section 5 authority.⁸ He believes that an unfair method of competition should be defined as an act or practice that (1) harms or is likely to harm competition significantly and (2) lacks cognizable efficiencies.⁹ In later public statements, Commissioner Wright has also offered support for a standard that weighs the harms and the benefits from the conduct at issue.¹⁰

Commissioner Ohlhausen is also an advocate for formal written guidance, and has proposed defining unfair methods of competition to require conduct (1) resulting in substantial

⁷ W. Kovacic & M. Winerman, *Competition Policy and the Applications of Section 5 of the Federal Trade Commission Act*, 76 ANTITRUST L. J. 929, 944 (2010).

⁸ See, e.g., Remarks of Joshua D. Wright, Comm'r, FTC, *Section 5 Revisited: Time for the FTC to Define the Scope of Its Unfair Methods of Competition Authority*, at 5 (Feb. 26, 2015) available at https://www.ftc.gov/system/files/documents/public_statements/626811/150226bh_section_5_symposium.pdf; Joshua D. Wright, Comm'r, FTC, *The Need for Limits on Agency Discretion & The Case For Section 5 Guidelines* (Dec. 16, 2013), available at https://www.ftc.gov/sites/default/files/documents/public_statements/need-limits-agency-discretion-case-section-5-guidelines/131216section5_wright.pdf.

⁹ Statement of Commissioner Joshua D. Wright, Comm'r, FTC, *Proposed Policy Statement Regarding Unfair Methods of Competition Under Section 5 of the Federal Trade Commission Act*, at 2 (June 19, 2013), available at https://www.ftc.gov/sites/default/files/documents/public_statements/statement-commissioner-joshua-d.wright/130619umcpolicystatement.pdf [hereinafter *Wright Statement*].

¹⁰ Joshua D. Wright, Comm'r, FTC, *The Need for Limits on Agency Discretion & The Case For Section 5 Guidelines*, at 15-16 (Dec. 16, 2013), available at https://www.ftc.gov/sites/default/files/documents/public_statements/need-limits-agency-discretion-case-section-5-guidelines/131216section5_wright.pdf.

harm to competition, but (2) having no pro-competitive justification (or be such that the harm is disproportionate to the benefits).¹¹

Table 1: Summary of FTC Commissioner Views Calling for Section 5 Guidance

Commissioner	Proposed Approach
Wright (R)	<ul style="list-style-type: none"> • Unfair method of competition is an act or practice that: (1) harms or is likely to harm competition significantly and (2) lacks cognizable efficiencies. • “[A]mbiguity associated with the current state of the Commission’s application of its unfair methods of competition authority can lead to overbroad enforcement that creates uncertainty in the business community about the legality of various types of business conduct.” • “Congress envisioned that Section 5 would play a key role in the Commission’s mission by leveraging its unique research and reporting functions to develop evidence-based competition policy, but failed to articulate a coherent framework for applying its unfair methods of competition authority.”¹² • The “vague and ambiguous nature of Section 5” is in effect a lost opportunity to apply Section 5 “in a manner that consistently benefits rather than harms consumers.”¹³
Ohlhausen (R)	<ul style="list-style-type: none"> • Unfair method of competition requires: (1) substantial harm and (2) no pro-competitive justification or harm disproportionate to the benefits. • “Section 5 (properly interpreted) should not play a significant role in the FTC’s competition enforcement efforts.”¹⁴ • “Before invoking Section 5 to address business conduct not already covered by the antitrust laws (other than perhaps invitations to collude), the Commission should fully articulate its views about what constitutes an unfair method of competition”¹⁵ • “[T]he Commission’s actions fail to provide meaningful limiting principles regarding what is a Section 5 violation”¹⁶

¹¹ Maureen K. Ohlhausen, Comm’r, FTC, Remarks before U.S. Chamber of Commerce, *Section 5: Principles of Navigation* (July 25, 2013), available at <https://www.ftc.gov/public-statements/2013/07/section-5-principles-navigation> [hereinafter *Ohlhausen Statement*].

¹² *Wright Statement*, *supra* note 9, at 2.

¹³ Remarks of Joshua D. Wright, Comm’r, FTC, *Section 5 Revisited: Time for the FTC to Define the Scope of Its Unfair Methods of Competition Authority*, at 5 (Feb. 26, 2015), available at https://www.ftc.gov/system/files/documents/public_statements/626811/150226bh_section_5_symposium.pdf.

¹⁴ *Ohlhausen Statement*, *supra* note 11, at 19.

¹⁵ See *In re Robert Bosch GmbH*, FTC File No. 121-0081, Statement of Commissioner Maureen K. Ohlhausen, at 3 (Nov. 26, 2012), available at <http://www.ftc.gov/os/caselist/1210081/121126boschohlhausenstatement.pdf>.

¹⁶ *In re Motorola Mobility LLC & Google Inc.*, FTC File No. 121-0120, Dissenting Statement of Commissioner Maureen K. Ohlhausen, at 5 (Jan. 3, 2013), available at <http://ftc.gov/os/caselist/1210120/130103googlemotorolaohlhausenstmt.pdf>.

IV. COMMON LAW

Chairwoman Ramirez and Commissioner Brill have made it clear that they prefer the status quo “common law” approach to Section 5 enforcement. They have taken the position that there is sufficient guidance in past Commission policy actions,¹⁷ Section 5 cases, and consents previously filed, such that the precise boundaries of the FTC’s Section 5 authority need not be separately defined (*see* Table 2). Those who take this position argue that just as the common law of the Sherman and Clayton Acts has developed and changed over time, the scope and role of Section 5 enforcement can and should develop over time.

Table 2: Summary of FTC Commissioner Views Suggesting the Common Law Approach¹⁸

Commissioner	Proposed Approach
Chairwoman Ramirez (D)	<ul style="list-style-type: none"> • Need a showing of harm to competition, and there should be a balancing of efficiencies – “condemn conduct only where, as with invitations to collude, the likely competitive harm outweighs the cognizable efficiencies.”¹⁹ • “I favor the common law approach, which has been a mainstay of American antitrust policy since the turn of the twentieth century.”²⁰ • “In my view, our enforcement actions themselves provide useful guidance for the business community.”²¹
Brill (D)	<ul style="list-style-type: none"> • Demonstrable adverse effect on competition • “...it’s pretty clear that Congress intended Section 5 . . . to be a common law statute, the interpretation of which would be developed through case-by-case analysis.”²²

Although the formal guidance approach preferred by Commissioners Ohlhausen and Wright offers the prospect of more detailed guidance, it is notable that the standards that both recommend are very similar to the standards that Chairwoman Ramirez and Commissioner Brill

¹⁷ Such as the workshop on the topic in 2008: “Section 5 of the FTC Act as a Competition Statute,” Oct. 17, 2008, *available at* <http://www.ftc.gov/news-events/events-calendar/2008/10/section-5-ftc-act-competition-statute>.

¹⁸ Although Commissioner McSweeney has not formally expressed her views publicly, she has referenced the FTC’s use of Section 5 in the standard-setting context without questioning those actions or calling for particular guidance. *See, e.g.*, Remarks of Commissioner Terrell McSweeney, Comm’r, FTC, Cravath/NYC Bar Institute for Corporate Counsel, at 7 (Dec. 10, 2014), *available at* https://www.ftc.gov/system/files/documents/public_statements/604511/mcsweeney_-_cravath_nyc_bar_corporate_counsel_keynote_12-10-14.pdf (“The FTC has been – and will continue to be – very focused on the licensing practices surrounding FRAND-encumbered standards essential practices.”).

¹⁹ Edith Ramirez, Chairwoman, FTC, *Unfair Methods and the Competitive Process*, George Mason Univ. Symposium, at 6 (Feb. 13, 2014), *available at* https://www.ftc.gov/system/files/documents/public_statements/314631/140213section5.pdf.

²⁰ *Id.* at 8.

²¹ *Interview with Chairwoman Edith Ramirez*, THE THRESHOLD (ABA Sec. of Antitrust L. Mergers & Acquisitions Committee), Spring 2014, at 9, *available at* http://www.ftc.gov/system/files/documents/public_statements/294181/140326thresholdspringissue_0.pdf.

²² *Interview with Julie Brill*, ANTITRUST SOURCE (Feb. 2012), at 6, https://www.ftc.gov/sites/default/files/documents/public_statements/interview-ftc-commissioner-julie-brill/120229antitrustsource.pdf.

believe flow from the common law approach. It seems that all the Commissioners agree that competitive harm should be the linchpin of a standalone Section 5 action, and that the Commission would need to balance any such harm against cognizable efficiencies.

The Commissioners also seem comfortable using Section 5 to take action against invitations to collude, on the grounds that such conduct, although not a violation of the Sherman Act, is without any redeeming pro-competitive benefit.²³

Although the Commissioners generally agree that “competitive harm” should serve as the standard under Section 5, there is a divergence of opinion on what role Section 5 should take in FTC’s enforcement efforts. Commissioner Ohlhausen believes that “Section 5 (properly interpreted) should not play a significant role in the FTC’s competition enforcement efforts” – the FTC should instead focus on making “valuable contributions to the antitrust laws, not in how it can pursue expansive UMC [unfair methods of competition] cases under Section 5.”²⁴

Similarly, Commissioners Ohlhausen and Wright have expressed a view that the FTC’s recent standard-setting cases overstep the proper scope of the FTC’s standalone Section 5 authority, partly based on a view that the economic basis for those enforcement actions remains unsettled and thus do not justify what they consider to be an expansive use of Section 5.

These differences in enforcement approach are not likely to be erased, even by fairly detailed guidance. Indeed, similar conflicts arise in most areas of antitrust enforcement, including, for example, merger analysis, which is often guided by the highly detailed Horizontal Merger Guidelines. Thus, with no immediate prospect of formal, detailed written guidance (and knowing that even if such guidance were to emerge it might not immediately provide substantially greater insight into how the Commission views the appropriate application of Section 5), companies and their counsel are best served, at least for the moment, by viewing recent Commission enforcement actions for direction regarding how its standalone Section 5 authority is likely to be used.

The types of conduct that the Commission has repeatedly pursued under its standalone Section 5 enforcement authority are summarized in Table 3. These include “invitations to collude” cases, various forms of “opportunistic” conduct in the standard-setting context, and exchanges of competitively sensitive information. Given the views of the majority of the Commission, these practices currently should be considered “high risk” under Section 5.

²³ See, e.g., Press Release, *Two Barcode Resellers Settle FTC Charges That Principals Invited Competitors to Collude*, FTC, Jul. 21, 2014, available at <https://www.ftc.gov/news-events/press-releases/2014/07/two-barcode-resellers-settle-ftc-charges-principals-invited> (5-0 Commission vote to challenge an invitation to collude under Section 5).

²⁴ *Id.* at 19, 21.

Table 3: Summary of Recent FTC Section 5 Enforcement—Unfair Methods of Competition

Conduct/Practice	Recent Cases	Guidance
Invitations to collude ²⁵	<ul style="list-style-type: none"> • <i>InstantUPCCodes.com</i> (Jul. 21, 2014) • <i>U-Haul</i> (June 9, 2010) • <i>Valassis Communications</i> (Apr. 28, 2006) 	<ul style="list-style-type: none"> • Solicitations or invitations to collude on price or output violate Section 5 • No agreement/acceptance of invitation required • Public or private solicitations are prohibited
Standard-setting conduct ²⁶	<ul style="list-style-type: none"> • <i>Bosch</i> (Dec. 3, 2012) • <i>Google/MMI</i> (Jan. 11, 2013) • <i>N Data</i> (Jan. 31, 2008) • <i>Rambus</i> (Aug. 2, 2006) 	<ul style="list-style-type: none"> • “Opportunistic conduct” in the standard-setting context may violate Section 5 • No agreement required • Seeking injunctive relief on FRAND-encumbered standard-essential patents may violate Section 5
Exchanges of competitively sensitive information ²⁷	<ul style="list-style-type: none"> • <i>Bosley</i> (Apr. 8, 2013) 	<ul style="list-style-type: none"> • Exchange of competitively sensitive non-public information with and about competitors violates Section 5 • No agreement required

Although not recent, there is Court of Appeals precedent, albeit somewhat limited, defining the parameters of and imposing limits on standalone Section 5 enforcement. The three most-prominent Court of Appeals decisions, each of which reversed FTC attempts to use its standalone Section 5 authority, are summarized in Table 4 below:

²⁵ *InstantUPCCodes.com* (July 21, 2014); *U-Haul Int’l, Inc.*, 75 Fed. Reg. 35,033, Jun. 9, 2010; *Valassis Communications*, April 28, 2006.

²⁶ *In re Robert Bosch GmbH*, 77 Fed. Reg. 71,593, Dec. 3, 2012; *In re Motorola Mobility LLC & Google Inc.*, 78 Fed. Reg. 2,398, Jan. 11, 2013 (relying on Section 2 court decisions involving bad faith and deceptive conduct and the FTC’s *N-Data* decision to show that “under its stand-alone Section 5 authority, the Commission can reach opportunistic conduct that takes place after a standard is adopted that tends to harm consumers and undermines the standard-setting process”); *In re Negotiated Data Solutions, LLC (N-Data)*, 73 Fed. Reg. 5,846, Jan. 31, 2008; *In the Matter of Rambus Inc.*, Opinion of the Commission, Docket No. 9302, Aug. 2, 2006, available at <https://www.ftc.gov/sites/default/files/documents/cases/2006/08/060802commissionopinion.pdf>.

²⁷ Complaint, *In the Matter of Bosley, Inc. et al.*, Apr. 8, 2013, available at <https://www.ftc.gov/sites/default/files/documents/cases/2013/04/130408bosleycmpt.pdf>.

Table 4: Prominent Section 5 Court of Appeals Decisions

Case	Holding	Reasoning
<i>Ethyl Corp.</i> (2d Cir. 1984)	No liability for parallel acts/tacit agreement without (1) evidence of anticompetitive intent or purpose or (2) the absence of an independent legitimate business reason for its conduct. ²⁸	In context of allegations of price-signaling via use of uniform delivered pricing the Court warned against “arbitrary and capricious administration of §5” and noted that the FTC must more clearly articulate how conduct that it challenges is “unfair” within the meaning of § 5 . . . to discriminate between normally acceptable business behavior and conduct that is unreasonable or unacceptable.” ²⁹
<i>Boise Cascade</i> (9th Cir. 1980)	No liability for conscious parallelism without evidence/finding of actual effect on competition. ³⁰	Court found that in multiple cases FTC had allowed delivered pricing in similar contexts and that the FTC had offered no evidence of actual effect on competition.
<i>Official Airline Guides</i> (2d Cir. 1980)	No liability for refusing to deal with a particular class of customers, even if it harms them: “We think that even a monopolist, as long as he has no purpose to restrain competition or to enhance or expand his monopoly, and does not act coercively, retains this right.” ³¹	Publisher of a flight schedule publication refused to deal with a particular type of customer (commuter airlines for a flight schedule publication) and court found that “enforcement of the FTC’s order . . . would give the FTC too much power to substitute its own business judgment for that of the monopolist in any decision that arguably affects competition in another industry.” ³²

The FTC’s recent round of standard-setting cases were resolved with consent decrees and thus were not subject to review in federal court. However, the D.C. Circuit, in reviewing and dismissing the FTC’s Section 2 claims in the *Rambus* case, expressed “serious concerns about the strength of the evidence relied on to support some of the Commission’s crucial findings” in relation to its “stand-alone § 5 action.”³³ Further, the Court held that the Commission had failed to make a key finding—that *Rambus* had obtained its monopoly power as a result of deceptive conduct within the standard-setting organization.³⁴ Without such a finding, the Court held that the conduct at issue could not be the basis of liability under the Sherman Act or Section 5. *Rambus* thus provides at least one clear boundary for Section 5 enforcement.³⁵

V. LIKELY PATH FORWARD?

There is no question that more information and detailed guidance regarding the FTC’s Section 5 enforcement principles would be welcome. And, given the prominence of the issue in recent months and years, the Chairwoman and individual Commissioners are more frequently issuing detailed statements at the conclusion of FTC enforcement actions. Although these

²⁸ See *E.I. Dupont de Nemours & Co. v. FTC* 729 F.2d 128 (2d Cir. 1984) (also known as *Ethyl Corp.*).

²⁹ *Id.* at 138.

³⁰ *Boise Cascade Corp. v. FTC*, 637 F.2d 573, 581-82 (9th Cir. 1980).

³¹ *Official Airline Guides v. FTC*, 630 F.2d 920, 927 (2d Cir. 1980).

³² *Id.* at 927.

³³ *Rambus Inc. v. FTC*, 522 F.3d 456, 467 (D.C. Cir. 2008).

³⁴ *Id.* at 467-69

³⁵ *Rambus* also demonstrates a commonsense, but important point in the “guidelines vs. common law” debate: whether or not there is FTC guidance on Section 5, the Courts of Appeals (and possibly the Supreme Court) will be the ultimate arbiter of the FTC’s use of Section 5.

statements fall short of a uniform policy statement, they nevertheless prove helpful to businesses navigating similar issues. For example, Chairwoman Ramirez describes the *Google/MMI* order relating to standard-setting in just that way, noting “the broad principles embodied in the order provide a roadmap for parties that want to avoid FTC scrutiny to follow under similar circumstances.”³⁶

However, despite the recurring calls for a Section 5 policy statement or enforcement guidelines, there has been no public indication that the FTC has any current plans to issue such guidance. Even if the Commission were to issue a Section 5 policy statement today, there is no guarantee that the statement would provide substantial detail or even that it would survive as the Commission’s composition (or political majority) changes over time.³⁷

Thus, at least for the foreseeable future, Chairwoman Ramirez’s view states the rule: Recent FTC enforcement actions and the Commissioners’ statements in those actions are the best “roadmap” for Section 5 enforcement.

³⁶ E. Ramirez, Chairwoman, FTC, *Standard-Essential Patents and Licensing: An Antitrust Enforcement Perspective*, 8th Annual Global Antitrust Enforcement Symposium, Georgetown University Law Center, at 6-7 (Sep. 10, 2014).

³⁷ Other enforcement guidelines have had a mixed record of utilization and longevity – the DOJ/FTC Horizontal Merger Guidelines (detailing factors for liability under Section 7 of the Clayton Act) have been updated several times to reflect current agency practice and are widely relied upon by practitioners and frequently cited by courts, while the DOJ’s 2008 Section 2 report (detailing factors for liability under Section 2 of the Sherman Act) was quickly rescinded, and the FTC’s Policy Statement on Monetary Equitable Remedies in Competition Cases, originally issued in 2003, was withdrawn in 2012. See Press Release, Justice Department Withdraws Report on Antitrust monopoly Law, May 11, 2009, *available at* http://www.justice.gov/atr/public/press_releases/2009/245710.htm; see also Competition and Monopoly: Single-Firm Conduct Under Section 2 of the Sherman Act, U.S. Dep’t of Justice, 2008, *available at* <http://www.justice.gov/atr/public/reports/236681.pdf>; Press Release, FTC Withdraws Agency’s Policy Statement on Monetary Remedies in Competition Cases; Will Rely on Existing Law, July 31, 2012, *available at* <https://www.ftc.gov/news-events/press-releases/2012/07/ftc-withdraws-agencys-policy-statement-monetary-remedies>.

CPI Antitrust Chronicle

July 2015 (2)

Online Advertising Platforms and Personal Data Retail: Consequences for Antitrust Law

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Online Advertising Platforms and Personal Data Retail: Consequences for Antitrust Law

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I. INTRODUCTION

It is not surprising how much attention has been given to the digital economy over the past decade, especially to online advertising platforms (“OAPs”).² However, despite the vast economic, legal, and even sociological literature on the topic, some aspects of the discussion remain insufficiently theorized. One such aspect is antitrust law’s insertion into the debate. Thankfully, that trend is now slowly being reversed. My intention in this article is to contribute to this trend, by briefly outlining aspects of the OAP discourse that should be taken into consideration by antitrust authorities in their decision-making processes.

II. THE PROBLEMS WITH THE TWO-SIDED PLATFORM MODEL

The first studies regarding online platforms and antitrust were conducted by economists who advanced the now famous and well-established two-sided platform model.³ Researchers started describing all online platforms according to this model, originally developed to explain transactions such as those in the credit card industry. These efforts were, and still are, extremely relevant for antitrust analysis. However, the multi-sided model has been stretched too far. Treating online platforms as two-sided in all cases does not yield the best possible results for antitrust analysis and, as such, one should question whether continuing to apply it without qualification is the most suitable course forward.

Bluntly, the answer is no. There are platforms that fit the two-sided model poorly and whose antitrust analysis could thus profit from a different framework. One such alternative model was presented in 2013 by Giacomo Luchetta in his article *Is Google a Two-Sided Platform?*⁴ According to Luchetta, what Google does—and, in my view, several other OAPs including Facebook do—is not part of a single market structure, as is the case in traditional multi-sided

¹ Legal assistant of the President of the Brazilian Antitrust Authority (CADE). Any and all opinions set out in this article are my own and do not reflect an official position of CADE.

² The definition of an online advertising platform is purposefully broad: I take an online advertising platform (“OAP”) to be any online platform whose profit depends on advertising.

³ This economic model is obviously far more detailed and complex. For an overreaching approach on the propositions and specifics of two-sided markets, see Jean-Charles Rochet & Jean Tirole, *Two-Sided Markets: an overview*, FRB ATLANTA (March 21, 2004), available at https://frbatlanta.org/filelegacydocs/ep_rochetover.pdf, last accessed February 9, 2015. In brief, one could say two-sided platforms, according to these authors, function by bringing together two groups of consumers that would otherwise be left apart. More than that, what brings them together is a platform that internalizes externalities produced by both groups. Such internalization would not be possible were it not for the platform, meaning that the groups are dependent not only on each other, but also, and more importantly, on the platform.

⁴ Giacomo Luchetta, *Is The Google Platform a Two-Sided Market?* 10(1) J. COMPETITION L. & ECON. 185-207 (2014).

platforms. Rather Google's platform includes two separate transactions: one downstream, between advertisers and the platform, and another upstream, between the platform and users. Luchetta characterizes this latter transaction as "personal data retailing." The connection between users and advertisers, rather than being dependent, runs from the business options made by OAPs to monetize themselves, not from the intrinsic structure of the platforms, and is not essential for their functioning.

A primary example of this is Ello, an advertisement-free social network that decided to make money in a rather different fashion: by charging users directly for new features introduced on its platform.⁵ This revenue model is possible only because, unlike with credit cards where consumers will only be interested in having a card if a wide range of businesses accept them as payment methods, the users accessing OAPs do not need advertisers, they simply tolerate them.

Nonetheless, there is no denying that advertisers and users share a close connection. The upstream market provides the raw material for the downstream market; that is, users provide the platforms with personal data that will later be used to build profiles in order to facilitate behavioral targeting. Still, the key aspect that should be noted is this transaction is not two-, but one-sided. Users provide data. Advertisers provide nothing in return, except advertisement itself.⁶

Assuming this argument is correct, and OAPs are not always well-characterized by a two-sided model, but rather best described as personal data retailers, there remain two questions to be answered, namely (i) how should the limits of that new market model be delineated and (ii) what are the consequences for antitrust.

Regarding the first question on market delineation, the market should be defined not by the use a platform has for individuals (e.g. Facebook and LinkedIn are social networks; Google, Yahoo! and Bing are search engines; Gmail and Hotmail are e-mails providers), but by the use the platform makes of its data collection. All of these companies collect personal information from their users and perceive it as raw material for their advertising businesses. In other words, one must abandon a product-based market definition, as this is unable to capture the complexities of personal data as a product.

Despite offering different functionalities, Google, Facebook, Hotmail, LinkedIn, Yahoo!, Bing, and many others all: (i) count on an upstream user-platform market; (ii) provide

⁵ For more on Ello and how the social network functions, see Ben Griffin, *What is Ello? A guide to Facebook competitor without adverts*, available at <http://www.digitalspy.co.uk/tech/feature/a602490/what-is-ello-a-guide-to-facebook-competitor-without-adverts.html#~:phdAGEH6s64TvZ>, last accessed June 2, 2015.

⁶ Although users clearly are beneficial to advertisers (the more users, the more eyeballs, the more brand awareness, and the more chances to sell products), advertisers are, in the best case scenario, irrelevant to users. Advertising is a price users have to pay in order to access the platform, but it is not necessary for them. For a deeper analysis on the value of advertising for users, see Scott McCoy, et al., *The Effects of Online Advertising*, Communications of the ACM - Emergency response information systems: emerging trends and technologies 84-88 (March 2007); Chingning Wang, et al., *Understanding Consumers Attitude Towards Advertising*, AMCIS 2002 Proceedings, 1143-1148 (2002); William M. Wielbacher, *How Advertising Affects Consumer*, 43(2) J. ADVERTISING RESEARCH 230-234 (June 2003); and Robert H. Ducoffe, *How Consumers Assess the Value of Advertising*, 17(1) J. CURRENT ISSUES & RESEARCH IN ADVERTISING 1-18 (1995).

advertising space in the downstream market; and (iii) connect these two markets through personal data, by transforming information into raw material. They should, for this reason, be classified as OAPs.

As for the consequences for antitrust, there is a foundational need to recognize that at least part of what is normally considered to be “privacy,” notably personal data, has been monetized and is now part of the market. Whether that is desirable or not is another discussion, which I believe to be crucial and must also be part of the agenda. Nonetheless, that specific debate is not essential to my current analysis, simply because my intention is to delineate how externalizations of privacy are already an asset.

III. ANTITRUST MAY BE AFFECTED BY THE PERSONAL DATA RETAIL MODEL IN AT LEAST FOUR WAYS

A. *In Relevant Market Definition*

Merger analysis is almost always accompanied by relevant market definitions. Such definitions suffer considerable modification once personal data retail is introduced. It no longer makes sense to adopt a user-centered approach and divide OAPs according to the service they provide. Social networks clearly have a very different role to play when compared to e-mail providers or search engines, if the analysis focuses on how these platforms fulfill users’ needs.

It is more appropriate to divide OAPs according to how they treat ad space and with whom they compete in regards to advertiser-platform transactions. The consequences of such an approach would be significant. The categorization of some of today’s largest web businesses as part of different markets, and therefore not a threat to competition, would need to be revisited. It ceases to be pertinent if Google offers search, Facebook is a social network, and Hotmail an e-mail provider, and, instead, the focus shifts to advertisers’ perceptions of these platforms.

B. *As a Barrier to Entry*

Although it has been said that, when it comes to the internet, “competition is one click away,”⁷ this does not seem to be the case in practice. There is reason to believe that personal data has become vital for a company’s ability to provide an effective online platform.⁸ Such user

⁷ Larry Page, one of Google’s co-founders, famously used this phrase when referring to FTC’s investigation of some of Google’s practices.

⁸ A long-lasting discussion regarding search engines’ functionalities is particularly relevant to entry barriers. Such discussion arose with Microsoft’s Bing introduction into the market. Google had been the leader in online search for many years. In 2009, Microsoft released Bing, a platform aimed at competing with the market leader. Bing, however, failed to threaten Google’s dominant position, which brought about questions regarding Microsoft’s ability to develop an equally effective search algorithm without relying on one of Google’s biggest advantages: large amounts of data. Google had been in the search market for much longer than Microsoft and, during that time, it gathered a significant amount of information about its users. Could Bing’s lack of capacity to develop into a legitimate rival be due to its shortage of personal data? In other words, is Bing simply unable to provide an equally effective search mechanism, and thus attract more users, because Google imposes a barrier to entry in the form of personal data? The appropriate response seems to be negative, since Microsoft, after attempting for years, has reportedly been able to develop a capable engine, as well as gain more space in the market. Still, a definite answer on personal data’s precise role within search would require a careful analysis of both Google’s and Bing’s algorithms, something neither of the companies is likely to agree upon.

information was acquired over time by most of today's leading OAPs; initially without additional cost, as users readily provided this information to websites. If, however, a newcomer decides to compete with established OAPs, it will have to bear a significant cost in order to acquire an equivalent set of information.

C. From the Perspective of the Essential Facility Doctrine

If personal data was ruled to be an essential facility,⁹ it could then be understood that databases must be shared among OAPs, which would considerably alter existing market dynamics.

D. Through Vertical Integration

As personal data's prominence has grown, it has given rise to an entirely new set of companies collectively known as the "Web Analytics." Adobe Analytics, MixPanel, Google Analytics, and several others are applications focused on collecting information about users' online behavior and giving it meaning, in order to help other firms enhance their business strategies.¹⁰ Such companies have developed an entirely new market, commonly referred to as the tracking industry.¹¹

OAPs have demonstrated interest in being vertically integrated with tracking companies; that is aggregating and single-handedly providing a final product, thereby significantly diminishing (or even eliminating) outsourcing.¹² Vertical integration has produced a vast and contradictory body of literature but, controversies aside, excessive integration has long been considered to encourage monopolization and to strengthen market power. These effects can also be verified when it comes to OAPs, and so antitrust authorities should be aware of their existence. They may conclude integration does not pose a threat to competition, but recognizing integration exists is imperative to any well-grounded analysis.

⁹ A full reconstruction of the essential facilities doctrine is outside this article's scope, but it is sufficient to say that the theory is premised on the notion that the holder of an essential facility have a duty to share it with others, including their own competitors.

¹⁰ The group also comprises platforms such as DoubleClick, Xaxis, and Conversant Media, who are responsible for digital advertising offered through tracking and targeting. In Conversant's words: "For decades marketers have dreamed of engaging with each of their customers on an individual basis. Today, thanks to the Conversant Personalization Platform, many of the world's leading brands are engaging with their customers on a profoundly personal level. Our platform offers everything necessary to help you deliver more personalized and individualized communications. What's more, it's designed for flexibility; the level of personalization, data integration, creative development, cross-channel delivery and measurement sophistication are completely up to you."

¹¹ Tracking companies are not OAPs competitors. They are part of a distinct, although connected, market—one of which online platforms make extensive use—but they do not provide services for OAPs alone. A company interested in obtaining information about users who visit its homepage can very well contract a tracking company's service, in order to potentialize sales of its products, and this company need not be an OAP.

¹² The finest example on that regard is the Google/DoubleClick merger, which took place in 2007 and was submitted to several antitrust authorities, including the U.S. Federal Trade Commission, the European Commission, and CADE. It regarded the acquisition of an ad serving tool (or third party ad server), DoubleClick, by Google, the leading search engine in all three jurisdictions.

IV. TWO ILLUSTRATIVE BRAZILIAN CASES

The discussion outlined above is relevant for all jurisdictions that, despite legal and procedural differences (including regarding the understanding of antitrust regulation itself), face similar challenges in their day-to-day application of the law, especially in a field as globalized as the digital economy. Nonetheless, I would like to emphasize some aspects of the debate in Brazil, notably putting forward a brief description of two cases, both of which specifically dealt with the issue of personal data retail, as a means of reinforcing my previous understanding of this market and the aforementioned effects it has on authorities' decisions.

The two cases judged by CADE (from the Portuguese acronym for the Brazilian Administrative Council for Economic Defense) are business agreements¹³ involving Phorm Ltda., the Brazilian branch of Phorm Inc., with each of the telecommunications groups Oi and Telefónica. CADE approved both without imposing any restrictions.¹⁴ In both instances, Phorm intended to offer the companies its "Navigator" product, a tool installed in browsers that is capable of monitoring online activities in order to select advertisement compatible with users' interests, as well as its Open Internet Exchange ("OIX"), the product responsible for presenting the selected ads. The operations would involve vertical integration, for Phorm would control both the raw material needed for behavioral targeting (personal data) and the channels through which advertisement could be distributed.

The argument put forward by Phorm in order to justify integration was straight-forward: despite concentration, users' experience would be enhanced. The problem with that line of thought is it assumes advertisement is useful for users, which is frequently not the case.^{15,16} The more plausible defense argues that online advertisement is a rather fragmented market, and therefore the transaction would be unable to harm competition.

A. *Phorm/Oi*

CADE's decision regarding the first case, involving Phorm and Oi, highlights the following aspects: (i) the position Phorm would occupy due to its partnership with Oi follows from Oi's established market, meaning Oi could engage in the same behavior even without Phorm's participation; (ii) Oi's market share is not significant, and there are other significant players to be considered in the internet access market, namely NET and Telefónica; (iii) there is no assurance regarding the effectiveness of databases in mapping users' commercial interests;

¹³ Business agreements can be referred to as a merger in Brazil, depending on their resemblance to an M&A description.

¹⁴ The mergers are cases 08012.003107/2010-62 and 08012.010585/2010-29.

¹⁵ My goal is not to delve deeper in advertising usefulness, but numerous research has been conducted on the topic. One worth-mentioning reference is Hairon Li, et al, *Measuring the Intrusiveness of Advertisements: Scale Development and Validation*. 31(2) J. ADVERTISING 37-47 (2002). More than once, research has concluded users find advertising annoying. Studies on web advertising include Ruth Rettie, et al., *Does Internet Advertising Alienate Users?* Academy of Marketing (AM) Annual Conference 2001 Kingston Business School, 7 (2001), who conclude "Internet advertising annoys many consumers. (...) As users become more experienced, Internet advertising becomes more annoying, so that we should expect annoyance, and consequently click-through to increase."

¹⁶ One other argument that strengthens this claim is the use of ad-blockers, which, once installed in a user's computer, prevent advertising from being featured on webpages. The most popular ad-blocker today, Adblock Plus, has over 200 million downloads and over 18 million average users.

and (iv) online advertising is itself a market heavily dominated by Google, which means Phorm would be unable to exercise any significant anticompetitive influence in it.

I believe it is reasonable to assume these conclusions would be different if the market analyzed was not solely that of online advertising, but rather included personal data retail. I certainly cannot predict what the precise outcome would have been, for CADE's investigation might have taken a different path altogether, but it is likely some aspects of the case would have been looked at in a different light.

First, there would have been a higher level of scrutiny with regard to databases. In this scenario, the conclusions regarding Oi's market power could be different. Phorm would probably not leverage Oi's position in online advertising to the point of hindering competition, but from that assumption one cannot immediately conclude there would be no barrier to entry, nor that vertical integration would be absent. If personal data is an asset essential to online advertising, one would have to first analyze what Oi's and Phorm's dominion of such asset was before establishing whether or not a partnership between the two firms could endanger competition.¹⁷

Second, privacy would become more palatable to the antitrust authority, because it would be perceived as a legitimate raw material, a category CADE would be more comfortable with than that of fundamental rights.

Third, reinforcing information retention as a non-conclusive tool for mapping users' interests might be a naïve approach. There is enough evidence of the contrary to establish it as a legitimate antitrust concern when connected to personal data acquisition. If companies wish to convince authorities otherwise, they should be the ones with the burden of proof.

B. Phorm/Telefónica

In the second case, between Phorm and Telefónica, the discussion was virtually the same, but one aspect called the Commissioners' attention: Considering the previous operation between Phorm and Oi, this could be an opportunity for Oi and Telefónica to merge part of their activities using Phorm's product. In that sense, however, Commissioner Ricardo Machado Ruiz said the partnership should be allowed, for "there are not enough arguments that render it possible to analyze this AC [from the Portuguese acronym for concentration act] as the conjunction of Oi's and Telefónica's market share in the broadband market." He understood there was no direct communication between Oi and Telefónica, and therefore the transaction should be approved.

Councilman Marcos Paulo Veríssimo agreed with Ruiz's conclusions. He expressed his concerns regarding Oi and Telefónica's partnership in online advertising, but, following Ruiz's statement, stressed "the scenario [in which antitrust concerns would emerge] is, today, merely speculative." Veríssimo agreed with Ruiz's position because he did not observe any of the necessary conditions that would require CADE's interference, namely (i) the presence of a new agent, empowered with substantial market share; (ii) the ability to exercise and abuse a dominant

¹⁷ Massimo Motta says, about essential facilities, that authorities must verify (i) the substitutability degree of a given facility, in order to conclude if no other structure could be used in order to fill its gap; (ii) the economic agent's ability to reproduce the facility using its own resources; and (iii) the facility's joint use viability.

position; (iii) capacity to damage consumers, and/or (iv) the ability to foreclose the market to third parties.

Before CADE came to a final ruling, Commissioner Fernando de Magalhães Furlan made some relevant observations:

The simplest answer is that information and presentation are the products being sold. One sells information about users' broadband navigation history in the form of profiles. And one sells selected advertising to users with profiles desired by the advertiser. It is not an isolated transaction. In Phorm's system, these two services are inextricably tied together: the advertiser buys advertisement's presentation to users who pertain to a determined profile. In that context, the broadband user is not the client, but the product. The providers sell users' data and advertisement's presentation to this user. The real client is the advertiser.¹⁸

What he does not do, despite this very clear description, is define the market as personal data retail. Rather, he reclaims the two-sided model. In my view, this interpretation could gain from going one step further and outlining the business as that of personal data retail.

If what is sold to advertisers is users' personal information, why describe this market as two-sided? For it to be two-sided, users would have to gain something from advertisers. The only product advertisers have to offer is advertising itself and it has already been established that advertisement is not a product users need. The result is a market that is not two-sided.

Furthermore, the two-sided categorization, in this case, has implications that go beyond mere formality. From the moment one perceives personal data retail as a separate market, the very frame of the operation changes. It no longer involves a multi-sided platform, in which advertisers and end-users interact by use of broadband providers' tools, but rather personal data retail, in which users' information is the product.

Another of Furlan's comments regards the leveraging of Oi and Telefónica's market power in broadband access into online advertising, and the creation of an essential facility in the form of users' histories. According to Furlan, Phorm would be able to monitor all of Oi's and Telefónica's users whenever they navigated, something no other company can duplicate—not Google, not Facebook, not both of them combined—and would as such seize control of an essential input.

In addressing this argument, Veríssimo goes in the opposite direction, claiming “the intervention would not even be in line with the traditional essential facility doctrine, for it would affect, apparently, the product sold in the online advertising market, instead of the input necessary to act in this market.”¹⁹ He said that there are other strategies companies could resort

¹⁸ From the original in Portuguese: “A resposta mais simples é que estão sendo vendidos informação e apresentação. Vende-se a informação sobre o histórico de navegação na Internet dos usuários de banda larga na forma de perfis. E vende-se a apresentação de publicidade a usuários com perfis desejados pelo anunciante. Não se trata de uma venda isolada. No sistema da Phorm, esses dois serviços são vendidos de forma conjunta e inseparável: o anunciante compra a apresentação de publicidade aos usuários que pertençam a um determinado perfil. Nesse contexto, o usuário de banda larga não é o cliente, mas o produto. As provedoras vendem dados do usuário e vendem a apresentação de publicidade a este usuário. O real cliente é o anunciante.”

¹⁹ Translation from the original: “a intervenção sequer parecia coadunar-se com as versões tradicionais da

to in order to acquire users' information, and Phorm's approach would merely be a different method, not an essential facility. This argument would probably be differently put, however, if one analyzed personal data retail instead of broadband access or online advertising, and considered personal data to be the input.

Commissioner Furlan's arguments did not prevail and CADE's second ruling was the same as the previous one, but the cases are nonetheless meaningful as examples on how antitrust analysis could profit from different market models. In this article's view, the focal point in both instances is that Phorm could concentrate the market. CADE's observations are oriented toward online advertising and broadband access, but if one recognizes personal data retail as a separate market, it then becomes clear that Phorm would gain unprecedented access to users' information, and would be able to monetize such information into behaviorally targeted ads.

Furlan sees this as the creation of an essential facility within online advertising and the mitigation of competition in this industry, by means of a disguised partnership between Oi and Telefónica. This article argues it would also be the creation of a market player with a solid dominant position in the tracking industry, whose effects would impact online advertising.²⁰

V. FINAL NOTES

The two-sided market model is increasingly useful and present in antitrust analysis. In current discussions involving the so-called sharing economy, its relevance is indisputable. However, some markets could profit from a different analytical framework, and that is the case for OAPs. I argue, as the Phorm cases hopefully demonstrate, that authorities would have something to gain from viewing such platforms as personal data retailers, namely undergoing changes in the way they describe the relevant market, as well as on how they apply barrier to entry, essential facility doctrine and vertical integration considerations.

doutrina das essential facilities, uma vez que atingiria, aparentemente, o próprio produto vendido no mercado de intermediação publicitária, ao invés de atingir o insumo necessário para atuação nesse mercado.”

²⁰ Regarding the essential facility doctrine, Telefónica stated that any attempt to open access to the personal data database would configure a breach of intellectual property. Such a claim is entirely unsubstantiated, for if anyone's property was breached, it would be users'. There is no innovation added to this database that would render it protected under IP law.

CPI Antitrust Chronicle

July 2015 (2)

Ecuadorean Merger Control Regulation

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Ecuadorean Merger Control Regulation

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I. INTRODUCTION

As of October 2011, Ecuador became a jurisdiction where merger control review and prior authorization is required prior to a change in control. The Organic Law for the Regulation and Control of Market Power (“the Law”) was enacted in October 2011, implementing the first domestic competition regime in the country. The Law also created the Superintendency of Market Power Control (“Superintendency” or “Authority”) as its governing administrative authority in charge of the application of the Law, and a separate regulatory body, the Regulation Board, in charge of issuing governing regulations, sector-wide recommendations, and economic thresholds for mergers, among other powers.

Merger notifications are made with the Intendency for Concentration Control (“Intendancy”), an investigative authority who must issue a recommendation report for resolution by the First Instance Resolution Commission (“Commission”). The Merger Control Intendancy is solely vested with the powers of investigating notified and non-notified transactions, and for issuing its recommendation report to the Commission. This report contains an economic analysis of both the competitive landscape as well as the transaction’s potential impact on the competitive structure, and a final recommendation as to whether to clear the transaction, issue a conditional clearance subject to conditions, or deny the transaction. The First Instance Resolution Commission, a 3-person resolution panel, must then evaluate this recommendation report and issue its final decision. Although empowered to issue an independent decision, the majority of cases have been issued in line with the recommendation report.

The Intendancy is also authorized to act *ex officio* in the case of non-notified transactions that come to its attention. The Intendancy has been one of the busiest groups in the past year within the administrative structure of the Superintendency, with a large number of clearances and investigations.

The basic principles of the merger control regime are set forth in Chapter II, Section 4 of the Law, making any act deemed a “concentration operation,” subject to the merger control. Although exemplary acts are broadly defined, any act granting **control** or **substantial influence** in another party, exceeding either of two alternative thresholds, may be subject to mandatory merger control notification and prior approval before its execution in Ecuador. Among others, mergers and acquisitions, joint-venture and administration agreements, assignments of the effects of a trader, and other acts that lead to a change in control, or substantial influence, are defined as “concentration operations.”

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The broad scope of the law may determine that other forms of agreements could be subject to notification in this jurisdiction and may therefore merit further legal analysis with local counsel when the economic or market share thresholds are met. It is worthy to note that even if the parties do not have a direct business presence in Ecuador, merger control regulation may be mandatory, considering the effects-based approach instated by the Law.

II. NOTIFIABLE TRANSACTIONS

Jurisdiction is subject to a prior control and approval regime of concentration operations, which can be generally summarized as follows:

1. Economic concentrations are defined as a change or taking of control in one or several economic operators through the following acts:
 - Mergers;
 - Assignment of assets of a trader;
 - The direct or indirect acquisition of shares, equity, or debt certificates if they grant influence in others' decisions, giving the acquirer control or substantial influence in the other;
 - Joint-venture and administration agreements; or
 - Any other act or agreement transferring the assets of an economic operator, or granting it control or determinant influence on an economic operator's adoption of regular or extraordinary administration decisions.
2. The aforementioned exemplary acts, and others falling within this scope, will require the prior authorization of the Superintendency before their execution.
3. "Control" is defined by the regulation of the Law, as control over any contract, act or, bearing in mind *de facto* and *de jure* circumstances, circumstances which confer the possibility of exercising substantial or determinant influences over an enterprise or an economic operator. This control may be joint or exclusive.

III. THRESHOLDS

When an act is considered a "concentration agreement" in the terms of the Law, notification and prior approval will be mandatory if either an economic or market-share threshold is met:

A. Economic Threshold

When the combined annual turnover of the parties in Ecuador in the year preceding the transaction exceeds an amount fixed by the Regulation Board. The Regulation Board set this threshold through Resolution No. 002 of October 22 2013, effective as of November 27, 2013.² The turnover threshold is currently as follows:

² Resolution No. 002 of the Regulation Board was applicable after its publication in Official Registry No. 132 of 27 November 2013.

Type	RBU	Value
(a) Concentrations involving financial institutions and entities that participate in the stock exchange	3,200,000	U.S. \$1,132,800,000
(b) Concentrations involving insurance and re-insurance companies	62,000	U.S. \$21,948,000
Concentrations involving undertakings not contemplated in (a) and (b)	200,000	U.S. \$70,800,000
<p>* The basic unified remuneration in Ecuador for 2015 is U.S. \$354. † The unified basic remuneration changes yearly; thus, the amount in U.S. dollars provided above will change on a yearly basis.</p>		

B. Market Share Threshold:

Concentrations involving economic operators undertaking the same economic activity and where the concentration will result in a market share equal to or greater than 30 percent being acquired or increased.

IV. TIMING

Concentration operations that meet, or exceed, either of the aforementioned thresholds require clearance from the regulator in order to be executed. Notification must be made within eight calendar days from the date of “conclusion of the agreement.” Generally, conclusion of the agreement will take place on the date where the general terms and conditions of a transaction are decided by the parties, through a “letter of intent,” “memorandum of understanding,” “joint-venture,” or “share purchase agreement.”

The Regulation to the Law, however, provides further guidance in respect to the “conclusion” concept, and stipulates that it should occur at the following times:

- a) **Mergers:** From the moment when at least one of the participants at the shareholders’ meeting has agreed to the merger;
- b) **Assignment of assets of a trader:** From the moment the entities agree to the operation and determine the form, term, and conditions thereof; in the case of companies, as of the moment the assignment is approved by the shareholders’ meeting;
- c) **Direct or indirect acquisition of shares, equity or debt certificates:** From the time the participants consent to the operation giving rise to the concentration and they determine the form, term, and conditions for its performance; in the case of companies, as of the moment the assignment is approved by the shareholders’ meeting.

- d) **Joint-venture and administration agreements:** From the time the administrators have been designated by the shareholders' meeting; and
- e) **Any other act or agreement which grants control or determinant influence:** From the time the parties consent to the operation giving rise to the concentration and determine the form, term, and conditions for its performance.

V. REQUIREMENTS FOR NOTIFICATION

Merger notifications must be submitted by the party who acquires control, unless several undertakings are acquiring joint control in which case notice must be given jointly through a common attorney in fact. The Superintendency issued a filing form template on May 9, 2013, which must now be completed and used within all mandatory merger control filings.

The requirements and mandatory accessory documents are fixed by the regulation of the Law, and generally require information regarding the notifying entities, the transaction, the market structure, barriers to entry, efficiencies, and rationale for the transaction, among others. Accompanying documents principally relate to the corporate existence of the parties to the transaction, their financial statements, power of attorneys to represent the entities in the merger notification, and a sworn affidavit attesting to the veracity of the information being provided and the good faith calculation of the figures submitted to the authority.

VI. DEADLINES AND FILING FEE

As of the date of admittance to file as complete, the Superintendency is entitled to 60 working days to approve, deny, or impose conditions on the transaction. That period can be extended by the regulator for an additional 60 days, although it is still under discussion whether this additional term is a calendar or working day calculation. It is frequently the case that the Intendency issues one, or several, requests for information ("RFI's") prior to the admittance of the file as complete. Hence, the beginning of the clock is frequently delayed for several weeks following the original submission, or the term is suspended, while new RFI's are issued. In practice, merger control clearances can average between four-to-six months from the date of filing until a clearance decision is issued.

The Regulation grants the Superintendency the right to determine official fees for the evaluation of a concentration notification. On May 9, 2013, the Superintendency published Regulations containing the parameters that will be used to determine the fee that will be charged for the processing of each concentration notification. The Regulations establish that the processing fee will be the greatest of:

- a) 0.25 per cent of the income tax (paid in the previous fiscal year in Ecuador);
- b) 0.005 per cent of sales (obtained in the previous fiscal year from its activities in Ecuador);
- c) 0.01 per cent of the assets in Ecuador; or
- d) 0.05 per cent of the book equity in Ecuador.

Although the Regulations do not specify which of the involved undertakings' figures these parameters will apply to, it has been the reiterated practice of the Intendency to apply these figures to the combined entities in the case of mergers, and to the acquired or target entity in the case of acquisitions.

VII. EXEMPTIONS

Article 19 of the Law establishes that the following operations are exempted from the obligation to notify a) the acquisition of shares without voting rights, bonds, securities, or any other right convertible to shares without voting rights; and b) the acquisition of undertakings or economic operators that have been liquidated, or that have not had economic activity in the country in the past three years.

Fixing a serious practical issue that arose from the fact that merger control was instated on October 13, 2011, but the Superintendent was only appointed in July 2012 and took office on November 2012, the regulation of the Law created a legal obligation for companies that, while they could not notify during this period, still had to submit these notifications for control. It remains to be seen how this transitory provision of the regulation is applied, if transactions that were closed during these period were notified clearly out of deadline or investigated by the regulator for lack of notification in the future.

VIII. APPROVAL STATISTICS

At the present date, the regulator has (i) approved more than a dozen mandatory notifications, one of which was originally denied on formal grounds, but approved on appeal, (ii) issued a single denial of a transaction based on anticompetitive concerns, and (iii) issued a denial of a transaction on formalistic grounds, which had already been subject to the divestment of the acquired business and approval of such divestment. Industries where these transactions have been focused are the insurance, financial, food & beverage, container liner shipping, steel processing, oxygen production, and telecommunications industries, as can be summarized below from the publically available information:

Operators	Industry	Approval Date	Conditioned
Nutreco/Gisis	Balanceados	31/05/2013	No
Metlife/Genesis	Insurance	02/08/2013	No
Veolia/Interagua	Water Services	18/11/2013	No
Arca/Toni	Food & Beverages	14/02/2014	Yes
Cabcorp/Tesalia	Beverages	19/02/2014	Yes
Bimbo/Supan	Bread	24/06/2014	Yes
Proamerica/Produbanco	Financial	25/02/2014	No
Aercap/Aig	Aircraft Financing	25/03/2014	Inadmitted
Hapag-Lloyd/Csav	Container Liner Shipping	03/09/2014	No
Indura/Swissgas	Industrial Gas	25/08/2014	Denied
AT&T/Directv	Telecommunications	04/11/2014	Yes
Banco Del Pacifico/Iece	Financial	05/01/2015	No
Burlingtown/Chiquita	Banana Production	02/03/2015	No
Hamburg Sud/Ccni	Container Liner Shipping	03/09/2014	No
Conecel/Ecuadortelecom	Telecommunications	04/05/2015	No
Hebei Iron & Steel/Ipac	Steel Processing	07/05/2015	No
Bayer/Merck	Consumer Care Products	08/07/2015	No

IX. FINES

The Law is very severe on the application of fines for lack of, or late notification of, transactions subject to its control. The amount of fines will depend on the state of execution of the transaction once the regulator commences the investigation on the lack of notification. Late notification (outside of the eight-day term from execution) is considered a minor offense to the law. Execution prior to notification, or prior to approval, is considered a serious offense to the law. Execution of acts or agreements prior to notification, or prior to approval, is considered a very serious offense to the law. Minor offenses are subject to an 8 percent of the annual turnover, in Ecuador, of the combined entities in the year preceding the imposition of the fine, while serious and very serious offenses are subject to 10 percent and 12 percent corresponding to the annual turnover, respectively.

In addition to these exorbitant fines, the Authority can also order the divestment or unwinding of the transaction in case the effects of the non-notified transaction are considered anticompetitive, in order to restore the competitive process. The statute of limitations of the Authority to take knowledge of non-notified transactions expires four years from the date when it comes into its knowledge that a transaction subject to its control was not notified, thus making the risks of lack of notification, or gun jumping, practically indefinite.

X. CONCLUSION

Considering the Superintendency has had only a few years of practice, as well as a high degree of staff rotation, its practice can at times be unpredictable and deadlines may be extended further than anticipated. From a perspective of global transactions being cleared in different jurisdictions, merger notification should be filed in Ecuador far ahead of other jurisdictions, primarily because of the strict deadlines for notification and prior approval.

A reform may well be in place with regards to this strict eight-day deadline, although it remains in the parties' own interest to submit complete notifications as far in advance as possible given the requirement to have approval in order for the closing of transactions. The newest Merger Control Intendent has been viewed positively by practitioners, considering his predecessors' overly formalistic approaches to the application of inconsequential requirements in detriment of both approval times and the general investment climate in the country. And it is hoped that the regulator will be able to retain new qualified officials who are gaining practical experience in the field.

Finally, it is anticipated that greater predictability and clearer rules, which favor expeditious review and approval, particularly of non-problematic transactions or mere changes in control where a null impact on the market is anticipated, will be established.

CPI Antitrust Chronicle

July 2015 (2)

Debunking the Smallest Salable Unit Theory

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Debunking the Smallest Salable Unit Theory

Richard J. Stark¹

I. INTRODUCTION

Manufacturers of devices such as smartphones need licenses to intellectual property held by innovators. Naturally, as profit-maximizing entities, they prefer to acquire the licenses they need at the lowest possible cost—that is, for the smallest royalty payments, or even royalty free. To achieve this goal, companies favoring low or no royalties are busily advocating a number of legal theories and policy changes around the globe.

One of their favorites is the argument that royalties must be based on the “smallest salable patent-practicing unit” (“SSPPU”), that is, the smallest component in a multicomponent device that practices a patent. The SSPPU theory arose out of a few cases set in a very particular context: U.S. jury trials in actions brought by non-practicing entities (sometimes referred to as “patent trolls”) on a single or small numbers of patents. The theory was developed to offset a perceived tendency of jurors to overestimate reasonable royalties that might be agreed to in hypothetical negotiations. But now the proponents of low royalties or no royalties (generally device makers and their allies) eagerly seek to convert that narrow concept into a mandatory limitation on the freedom of real-world commercial negotiators of licenses to patent portfolios that include standard-essential patents (“SEPs”).

The most notable example of this trend occurred earlier this year when the device-maker lobby caused the IEEE to adopt changes to its patent policy that endorse SSPPU-based licensing for patents declared essential to IEEE standards. An advocacy piece for the device makers’ argument recently appeared in this journal.²

Whatever the merits of the SSPPU theory might be in the jury-trial context in which it arose, it plainly cannot apply in portfolio licensing of SEPs. The device makers’ arguments on this front fail to comport with (i) the applicable law, (ii) the relevant facts, and (iii) important practical considerations.

Their argument, in essence, is as follows: (1) FRAND licensing is not working, (2) the SSPPU theory is the proper and settled rule for determining patent infringement reasonable royalties in all cases, and (3) the SSPPU theory should therefore apply to SEP portfolios. Each link in this chain is mistaken. This article addresses these flaws in the context of the cellular communications industry.

II. IS FRAND LICENSING WORKING?

Yes. FRAND licensing in smartphones has worked, and continues to work, admirably. This is a simple fact, not open to serious debate. The cellular communications industry is one of

¹ Richard J. Stark is a partner in Cravath’s Litigation Department.

² See Joseph Kattan, *The Next FRAND Battle*, 3(1) CPI ANTITRUST CHRON. (March 2015).

the most innovative and dynamic industries ever. It is one of the most R&D intensive industries in the world.³ New devices are introduced quickly, with new and advanced functionality based upon expanding technological capabilities and performance. Yet device prices keep falling, and the functionality available at a given price (in terms of data transfer rates, processor speeds, user-level features, and other aspects) has exploded.⁴

Moreover, it is one of the most competitive industries in the world, as new entrants appear frequently, from all parts of the globe, including major successes such as Apple (since 2007) and Xiaomi (since 2011). Meanwhile, incumbents (such as Nokia, Ericsson, Motorola, and Blackberry) have either exited by divesting their handset divisions or seen their market shares collapse. The size of the handset market has greatly expanded, as global revenues have doubled in the last six years. According to Credit Suisse, handset manufacturer operating profits tripled between 2007 and 2013, reaching U.S. \$51 billion.⁵ Finally, while advocates for device makers have floated exaggerated estimates of mobile SEP royalties,⁶ an analysis by industry expert Keith Mallinson, based on publicly disclosed earnings reports, estimates the aggregate total of cellular royalties at below 5 percent of the total worldwide market for cellular handsets and infrastructure equipment.⁷

Ignoring these hard facts about the innovativeness, competitiveness, and profitability of the industry, the device makers contend that FRAND licensing is not working because, they say, SEP royalties are too high. To support this contention, they lean heavily on the concept of “royalty stacking.” The argument goes like this: If a manufacturer must pay a 1 percent royalty to patent holder A and a 1 percent royalty to patent holder B, the sum of those royalties amounts to a “stack” of 2 percent. If there are many holders of potentially applicable patents, just imagine how high the stack must be. Advocates have advanced this argument passionately for well over a decade in the smartphone arena.

³ Julio Bezerra, et al., *The Mobile Revolution: How Mobile Technologies Drive A Trillion Dollar Impact* 29, BOSTON CONSULTING GROUP, (Jan. 15, 2015), available at https://www.bcgperspectives.com/content/articles/telecommunications_technology_business_transformation_mobile_revolution.

⁴ See generally Bezerra, et al., *supra* note 3.

⁵ Credit Suisse, *The Wireless View 2014: Smartphones – A Slowing Disruptive Force*, (January 6, 2014) at 16 https://doc.research-and-analytics.csfb.com/docView?language=ENG&source=emfromsendlink&format=PDF&document_id=805847640&extdocid=805847640_1_eng_pdf&serialid=VKIqPfyGKvPXILC6%2bF%2bpFCXU1PjBAqenh6L1N6AVE%3d.

⁶ E.g., Ann Armstrong, Joseph J. Mueller, & Timothy D. Syrett, *The Smartphone Royalty Stack: Surveying Royalty Demands for the Components Within Modern Smartphones* (2014). This paper, self-published by the WilmerHale law firm, purports to collect the announced or demanded royalty rates for a number of components of smartphones and, on the basis of this survey, postulates that the aggregate royalties may amount to more than 30 percent, or over \$120 for a \$400 smartphone. However, these figures appear to be overstated for a number of reasons, including at least: (1) they do not reflect the royalties actually paid, even when accurate information is readily available; (2) they do not account for the effects of cross licensing and pass-through licensing; and (3) there are many patent holders who have not (or not effectively) sought to monetize their patents. Nokia, for example, stated in 2007 that it paid less than 3 percent total royalties on WCDMA handsets: Eric Stasik, *Royalty Rates and Licensing Strategies for Essential Patents on LTE (4G) Telecommunications Standards*, 113 LES NOUVELLES (Sept. 2010).

⁷ Keith Mallinson, *Smartphone Revolution*, IEEE CONSUMER ELECTRONICS MAG., 60 (April 2015).

The trouble is, the device makers have never provided any evidence to support this claim, nor even made representations concerning the total royalties they pay. Instead, they rely on the mere assertion that the royalty stack could be high. Frequent guest stars in the argument include citations to the royalty rates initially demanded by various licensors, which of course may (and do, in fact) differ substantially from what the licensors ultimately realize.

In terms of actual evidence of what the device makers truly pay, the record, even after years of dispute, remains barren. This fact is telling. If an unduly high, commerce- and progress-threatening stack of royalties lurked out there, who would know that? The device manufacturers, obviously, are the ones who claim that they have to pay excessive royalties, the ones who signed the license agreements (or settlements) that allegedly require these royalties, and the ones who could provide that evidence to prove their point. They possess complete information as to the total royalties actually being charged. But they have not come forward with this evidence.

Indeed, in the past several years, at least three cases involving SEPs have gone to trial in the United States.⁸ In all three cases, the device makers cried “beware the royalty stack!” But in none of the cases did the device makers provide a lick of evidence to show the amount of allegedly stacked royalties they paid, the licenses under which they agreed to those royalties, to whom they supposedly paid these royalties, or any of the circumstances surrounding the alleged payments. With all these opportunities to prove their point, the device makers are zero for three. The clear implication—and the only plausible explanation for this failure—is that the evidence does not exist. The device makers are not in fact paying high percentages of “stacked” royalties. Their argument is, politely put, merely theoretical.⁹

Separate and apart from royalty stacking, the device manufacturers contend that the royalties charged by the major SEP holders for access to their portfolios do not reflect the contribution of their cellular telephony SEPs to the overall technological content of today’s smartphones. The manufacturers argue that mobile phones have evolved substantially over the last decade, with the implementation of technologies such as geo-location, touch screens, high-resolution graphics, voice recognition, high-resolution cameras, and more, and that these technologies are “independent” of improved communications technology. The device makers then argue that, with the incorporation of so much non-telephony technology into smartphones, the royalties charged by holders of telephony SEPs should have declined, and yet, allegedly, the royalty demands of SEP holders have remained level.

This argument reveals a substantial misunderstanding (or mischaracterization) of the technologies at issue, as well as the associated patent portfolios and licenses. For starters, the argument assumes that the patent portfolios held by licensors are limited to patents that read on the relevant telephony standards and that those portfolios have remained static, unchanged, throughout the course of the evolution of end-user devices.

Neither assumption is correct. In fact, licensors typically offer licenses to their entire patent portfolios. In many cases those portfolios include patents reading on a wide variety of

⁸ *Microsoft v. Motorola, In re Innovatio* and *Ericsson v. D-Link*.

⁹ *Ericsson Inc. v. D-Link Systems Inc.*, 2013 WL 4046225, at *18 (E.D. Tex. 2013) (“The best word to describe Defendants’ royalty stacking argument is theoretical.”).

technologies incorporated into smartphones and other cellular equipment, including SEPs as to standards other than mobile telephony and non-SEPs relating to technologies other than pure communications, such as geo-location, video, touch screens, cameras, and many others.

And these portfolios are hardly static. New innovations are being developed and patented all the time. Often, the non-communications technologies touted by device manufacturers are first developed, tested, perfected, and patented by others, and only later incorporated by manufacturers into commercial phone designs.

Furthermore, within the realm of cellular communications, the major SEP holders have hardly stood still. Rather, they have devoted substantial resources to improving standardized communications technology from 2G through 3G, 4G, and soon 5G standards. The fruits of these efforts include new patents covering major improvements in communications capabilities. 4G data transmission rates are tens of thousands of times faster than 2G thanks to significant innovations by participants in the standard-setting process, and hundreds of times faster than 3G data rates.

These new SEP technologies have greatly improved spectral efficiency, literally multiplying the value of scarce spectrum and enabling that spectrum to support far more users sending and receiving far more data. Thus, newer generations of cellular innovation have created at least as much value for customers and carriers as older and more visibly “foundational” cellular innovations ever did.

Improvements in communications technology have enabled the myriad of data-intensive, always-on applications running on today’s mobile devices and directly drive and enhance the value of these and other technologies that device makers have included in their phones. These improvements are essential to the widespread utilization (and indeed relevance) of those added technologies. Imagine trying to use 2G technology to share slow motion videos taken on your new iPhone 6 (you wouldn’t even try). For this reason, among others, the industry has long recognized that inventions related to fundamental cellular technologies—without which today’s software and applications simply could not exist or would be useless—are best valued by looking at the whole device.

An example of the added value: Before the 32GB iPod Touch was taken off the market in September 2014, it retailed in the United States for \$249, as compared to \$649 for an unlocked 32GB iPhone 5c. These devices were very similar in hardware, operating system software, user applications, and capabilities—except for the LTE cellular capability of the iPhone. Consumers in the United States paid \$400 more for the device with LTE cellular capability (the iPhone 5c) than they did for the nearly identical device (the iPod Touch) that lacked cellular capability (and this doesn’t account for the hundreds of dollars typically paid each year for data plans that permitted use of the LTE network’s wireless data services).

This example shows that the addition of LTE wireless data services can more than double the value of a device, even holding the hardware and capabilities of the device essentially constant. With wireless communications capabilities generating such tremendous value for consumers (and wireless carriers), it is simply baseless to assert that wireless communications technology is proportionally less valuable in consumer devices today than it was in the past.

There is no support for the device makers' contention that patent royalties are unreasonably high. FRAND has worked, and continues to work, remarkably well.

III. IS THE SSPPU THEORY A SETTLED RULE DEFINING THE PATENT ROYALTY BASE IN ALL CONTEXTS?

Certainly not. The SSPPU theory does not define the patent royalty base for most purposes, let alone all purposes, and is particularly inapt for portfolio licensing. As an initial matter, the SSPPU theory does not dictate or even necessarily bear on what a willing licensor and a willing licensee may agree to in a commercial arrangement. Patent holders and device makers are free to agree upon license terms that work for them in their businesses.

In particular, both licensors and device makers typically find it beneficial to license whole portfolios at the device level. The reasons are simple. Device makers want freedom of action, and thus it makes sense, especially when dealing with a major patent holder, to insist on a license to all patents that could conceivably read on any aspect of the manufacturer's devices. The simplest and most expedient way to achieve this is to insist that, in exchange for an agreed-upon price, the licensor include all of its patents. From the licensor's perspective, too, this is the most efficient and reasonable way to license a portfolio of patents. Any given manufacturer or licensor could have, at any point in the lengthy history of the cellular industry, decided not to transact on the basis of portfolios and devices, but few have, because it is the commercially reasonable thing to do.

The SSPPU concept says nothing about the reasonableness and appropriateness of these commercial arrangements. It only purports to be a means of offsetting a perceived tendency of jurors to overestimate the royalties to which hypothetical negotiators would have agreed. In that context, the Federal Circuit has stated that SSPPU is not a "substantive legal rule," but rather an "evidentiary principle," the point of which "is to help our jury system reliably implement the substantive statutory requirement of apportionment of royalty damages to the invention's value."¹⁰ In short, properly understood, a district court's obligation is to exercise appropriate discretion to avoid jury confusion, not to reflexively apply the SSPPU theory.¹¹

The statutory rule, which must ultimately guide courts in determining patent infringement damages, is set forth in 35 U.S.C. § 284: "the court shall award the claimant damages adequate to compensate for the infringement, but in no event less than a reasonable royalty for the use made of the invention by the infringer." As that rule has been interpreted by the Federal Circuit (relying on the Supreme Court's guidance in *Garretson v. Clark*,¹²) "the ultimate combination of royalty base and royalty rate must reflect the value attributable to the infringing features of the product, and no more."¹³ Thus, "[w]hen the accused infringing products have both patented and unpatented features, measuring this value requires a determination of the value added by such features," and "[t]he essential requirement is that the

¹⁰ *Ericsson Inc. v. D-Link Systems Inc.*, 773 F.3d 1201, 1226 (Fed. Cir. 2014).

¹¹ *See id.*

¹² *Garretson v. Clark*, 111 U.S. 120, 121 (1884).

¹³ *Ericsson*, 773 F.3d at 1226.

ultimate reasonable royalty award must be based on the incremental value that the patented invention adds to the end product.”¹⁴

Economically, the value that the invention adds to the end product is related to the value of the end product including the technology in question minus the value the end product would have if it did not include the technology.¹⁵ Quite commonly, the value added may exceed the price of any component, including an alleged SSPPU. The value may be quite substantial, as suggested by the iPhone-iPod example discussed above.

As a further example, some have argued that WiFi chips designed for products compliant with the IEEE 802.11 WiFi standards constitute the SSPPU for SEPs as to those standards. WiFi chips are now priced as low as a few dollars apiece. Thus, the argument goes, any royalty for a WiFi SEP must be calculated using the cost of a WiFi chip as the royalty base, and the resulting royalty could not be more than a fraction of a few dollars. But the fact that a particular type of chip is important to the implementation of the WiFi standards does not mean that the value of all the patented technology that went into the WiFi standards is limited to a small percentage of a few dollars. The difference in value between a device, such as a laptop with WiFi capability, and one without such capability, may easily be more than the price of a WiFi chip.¹⁶

This is not to say that the value of any one WiFi SEP equals the total value of the WiFi standards. The point here is that there is no economic reason to conclude that the WiFi chip is the appropriate royalty base for such a patent. Ultimately, the value of an invention lies in the idea itself, and the benefit that idea imparts not to a particular chip or component, but rather to the ultimate user of the final product.¹⁷

While the SSPPU theory may be interesting to consider in the context of jury trials on single patents, the substantive legal rule, as explained by both the Supreme Court and the Federal Circuit, does not dictate that the SSPPU concept must be used to determine the royalty base in privately negotiated licensing transactions.

IV. SHOULD THE SSPPU THEORY APPLY TO SEP HOLDERS' PORTFOLIOS?

No. The SSPPU theory cannot, and should not, be applied to SEP holders' portfolios, for a number of reasons. First, it is not possible to map a portfolio of hundreds or even thousands of diverse patents to a single SSPPU. The patents in a typical large portfolio cover multiple different components of a smartphone, and include SEPs not only for a single communications standard, but also for multiple such standards. They include, as well, SEPs for other, non-communications standards and non-SEPs too. Each family of patents in a portfolio would potentially map to a different SSPPU, and the implied royalty base for the portfolio would therefore be the aggregate of all those components. Indeed, some patents cover complete handsets or entire communication

¹⁴ *Id.*

¹⁵ See Cristina Caffarra & Pierre Régibeau, *Patent Explosion and Patent Wars: Hold-Up, Royalties and Misunderstandings over 'Market Value'*, EUR. COMPETITION L. ANN. 307 (2012).

¹⁶ See *Commonwealth Sci. and Indus. Research Org. v. Cisco Sys., Inc.*, No. 6:11-cv-343, 2014 WL 3805817, at *11 (E.D. Tex. July 23, 2014) (“the chip itself is not the invention. . . . The benefit of the patent lies in the idea, not in the small amount of silicon that happens to be where that idea is physically implemented.”).

¹⁷ *Id.*

systems (including both handsets and network infrastructure equipment). Thus, the SSPPU for a typical, substantial portfolio in the cellular industry could, in fact, be the entire smartphone, or even the entire cellular communications system.

Second, trying to determine a portfolio royalty based on the SSPPU for every patent in a substantial portfolio of SEPs and non-SEPs would be an unmanageable (and pointless) task. The person-hours required to determine an SSPPU (often not a straightforward exercise) for each one of many thousands of patents would be enormous. Add to that the effort that would be expended in negotiations when potential licensees dispute the assignment of SSPPUs to patents and then dispute, patent by patent, the value of the SSPPU and the royalty rate for each patent.

Further, consider that negotiators would potentially have to replicate all of that analysis for each distinct device to account for the specific design and mix of components of that device. It quickly becomes evident that the SSPPU concept is being promoted merely as a means to beat down royalties—not as a method that could ever actually be used to negotiate large portfolio licenses in the real world. If a licensor and licensee foolishly attempted to invest the effort to negotiate in this fashion, the end result would be a royalty per device that equals the sum of all the sub-royalties on all the patents in the portfolio as to all the SSPPUs in the device. Exactly the same result can be achieved much more simply and efficiently by negotiating a single portfolio-wide royalty on the device.¹⁸

Third, the SSPPU theory is inconsistent with industry practice. For many years, licensees and licensors in the mobile communications world have operated on the basis of device-level portfolio licenses.¹⁹ There are sound reasons for this. As noted above, device-level portfolio licensing is efficient for everyone concerned. And device makers have a strong interest in licensing in this fashion. Device makers need licenses from those who have developed technologies implemented in their products and, most of all, they need freedom of action. Almost without exception, if a device maker's lawyer came home from a negotiation having settled for less than a whole-portfolio, whole-device license—that is, with only partial protection for the manufacturer's business—his career would take a rather abrupt detour.

In addition, there are historical reasons for maintaining the present system of device-level licensing. In general, the major patent holders already have license agreements with the device makers. These agreements cannot simply be abrogated, nor can they be easily unraveled and replaced by a whole new set of agreements. Even if such a change could be effected over time, it is far from clear that it would result in a very different value allocation among the players in the industry, or that a disruptive reallocation would increase consumer welfare. As noted above, the current FRAND licensing system has worked well and continues to work well. Changing the

¹⁸ Kattan, *supra* note 2 at 11, attempts to argue that applying the SSPPU theory to a portfolio is not impractical “as the need to demonstrate that a patent is infringed and link the infringement to a product feature exists independently of the royalty base.” This argument reflects a misunderstanding of licenses and license negotiations. There is no requirement in a business negotiation to demonstrate infringement patent by patent, and parties do not operate this way. In fact, one of the benefits of portfolio licensing is the avoidance of the cost of patent-by-patent disputes.

¹⁹ See Eric Stasik, *Royalty Rates and Licensing Strategies for Essential Patents on LTE (4G) Telecommunications Standards*, LES NOUVELLES (Sept. 2010).

existing system to the advantage of one group over another could reduce the incentives for firms to make the massive and risky investments needed to develop new technologies and standards, thus slowing the pace of innovation to the detriment of end users.

Proponents of the SSPPU theory ignore the actual facts of this marketplace and rely on unfounded, illogical assertions. Kattan, for example, uses the hypothetical of a handset manufacturer who makes two smartphones, one sold to end users for \$250, and one for \$400, both using “the same standard-compliant chipset.” He notes that using the phones’ prices as the royalty base “results in a royalty on the pricier phone that is 60 percent higher than that on the cheaper phone,” and suggests that this is an improper or undesirable outcome.

Kattan’s view flows from a number of factual and logical errors. A critical factual error lies in the assumption that the value of a SEP must be limited to a fraction of the price of a chipset. This is incorrect. As shown above, the economic value of a SEP is related to the value it contributes to the end product, not to the price of a subset of the components of the product. The claim that the value of a SEP is limited to a portion of the price of a chipset is nothing more than an arbitrary assumption, disconnected from any assessment of the value that the invention contributes to the standard-compliant product.

For example, the higher-priced phone in Kattan’s hypothetical would likely have more functionality and place greater demands on the always-on connectivity provided by the SEP technologies. In other words, the higher-end product derives more benefit from the SEP technologies. A higher royalty is appropriate given the value added to that device by those technologies.

In a second factual error, the hypothetical assumes that a “standard-compliant chipset” embodies all the patents in the portfolio of the SEP holder. Again, as discussed above, that is not necessarily the case. A significant patent portfolio will likely contain not only SEPs related to the communications standard in question but also many other patents reading on other technologies included in today’s smartphones. The more costly smartphone in the hypothetical may well include technologies that are not used in the cheaper phone but are covered by the portfolio in question.

Third, it is not even the case that any given SEP related to the communications standard in question will be completely embodied by the “standard-compliant chipset.” As noted above, SEPs can read on whole smartphones or whole communications systems. For those patents that read on a complete smartphone, the SSPPU could be the phone itself. There is something profoundly anomalous in the suggestion that the royalty for an infringing smartphone should be derived not from the price of the smartphone, but rather from the price of a subcomponent that, by itself, would not infringe.

In addition to these basic factual errors, Kattan’s hypothetical suffers from fatal logical flaws. To appreciate the logical issues, one might start by asking, “What is the most appropriate royalty for the licensed technology?” Suppose that the royalty rate in question is 1 percent. Kattan’s argument assumes that a royalty of 1 percent on the \$250 phone (\$2.50) is the correct royalty, and a royalty of 1 percent on the \$400 phone (\$4.00) is excessive. But what is the basis for that assumption? Why not assume that the \$4.00 royalty accurately values the technological contribution of the patents in question, and the \$2.50 royalty undercompensates the patent

holder? “Lower is better” is not an argument; it is merely an expression of the desire of handset makers.

A more expensive, high-end smartphone, with features such as a large, high-resolution screen, a high-quality camera, and photo and video editing capabilities, makes greater use of and benefits more from improved communications than a basic device does. A user of the more capable device will undoubtedly download, upload, stream, and post to social media more photos and videos, with bigger file sizes, as a result of higher resolutions. As an example, the vastly improved data transmission rates supported by the 4G LTE standard contribute far more value to such a high-end device than to a less capable phone. It is only fair that the maker of the device should pay more (in terms of a higher royalty) for the use of the technology in the phone that derives more value from the technology.

It is also useful to consider an alternate hypothetical. Suppose a handset maker produces a smartphone model using “standard-compliant chipsets” that it acquires for \$50 apiece. The manufacturer sells this model to end-users for \$400 each in year 1. In year 2, thanks to a new manufacturing plant coming on line, the chipset supplier is able to reduce the price of the chipset from \$50 to \$25. The handset manufacturer continues to sell the same handset for \$400. Are we to conclude that in year 1 the patented technologies incorporated into the smartphone are worth some fraction of \$50, and in year 2 those same technologies, used in the same phone, are worth 50 percent less?

What changed? Only the cost of manufacturing the chipsets, which surely had nothing to do with the value to the phone maker of being able to use the patented technologies. In fact, the smartphone became significantly more profitable in year 2, meaning that the privilege of selling a phone incorporating the patented technologies actually became more valuable.

V. CONCLUSION

There is no basis for applying the SSPPU theory to SEP holders’ patent portfolios. The arguments advanced in support of the SSPPU theory fail at every level: law, fact, policy, history, and practicality. Proponents of the theory will continue pushing it, of course, as a means to their desired end of depressing patent licensing royalties. While it is natural and expected that each economic actor should pursue its own interests, regulators, judges, and other policy makers should understand the self-interested nature of the arguments and should not be swayed by device makers’ efforts to improve their own bottom lines.

What matters is that the fruits of innovation are allocated both efficiently and in a way that tends to maximize social welfare by incentivizing further innovation. The present system of FRAND licensing has achieved those goals spectacularly well. Changing that system to please device manufacturers, allowing them to arrogate more wealth to themselves, would ultimately restrict innovation and work to the detriment of consumers.