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The European Commission's New Initiatives for Digital Platforms

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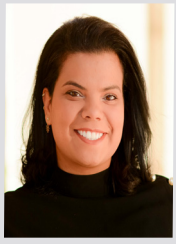

EI Senior Economist Jéssica Dutra consults on competition matters across a wide range of industries, including digital markets. Dr. Dutra also reviews issues pertaining to European competition policy.

The European Commission ("EC") is seeking to upgrade its toolbox for addressing competition issues in digital markets. In June 2020, the EC launched its initiative for a *New Competition Tool* ("NCT"), which allows the EC to impose behavioral and structural remedies in digital (and other) markets that current competition rules do not permit. In December 2020, the EC proposed two legislative initiatives: the Digital Services Act ("DSA") and the Digital Markets Act ("DMA"). The main goals of these acts are "creat[ing] a safer digital space in which the fundamental rights of all users of digital services are protected" and "establish[ing] a level playing field to foster innovation, growth, and competitiveness, both in the European Single Market and globally."

In particular, the DMA introduces rules for online platforms that act as "gatekeepers" in the digital sector. The focus on gatekeepers reflects the EC's concern that these platforms can potentially foreclose access between consumers and rival businesses within their platforms. The EC will evaluate three criteria to determine whether a platform is a "gatekeeper" and thus subject to the new rules. The criteria are 1) "a size that impacts the internal market," determined by the platform's annual net sales vis-à-vis the size of the European Economic Area (EEA) and its member states; 2) "control of an important gateway for business users towards final consumers," determined by number of active users and businesses; and 3) "an (expected) entrenched and durable position," presumed if the platform has met the previous two criteria for at least three financial years.

If a platform is identified as a gatekeeper, the DMA will require the platform to follow certain rules. Specifically, the platform must allow third parties to "interoperate" with the gatekeeper's own services in certain specific situations, provide performance measuring tools for advertisers using their platform to carry out independent verifications, allow for business users to contract with their customers outside the gatekeeper's platform, and provide their business users with access to the data generated by their activities on the gatekeeper's platform. Additionally, gatekeepers may no longer block users from un-installing any pre-installed software, may not use the data obtained from their business users to compete with them, and may not restrict their users from accessing services that have been acquired outside the gatekeeper's platform.

The EC's proposed initiatives, through both the DSA and DMA, are a significant effort to bolster enforcement and increase accountability of online platforms in digital markets.

Also In This Issue

Significance of Recent Pro-Patent Holder Decisions: Qualcomm and Unwired Planet

Robert D. Stoner

In August 2020, two appeals court decisions, one in the United States and one in the United Kingdom ("UK"), were rendered in important cases involving interpretation of Fair, Reasonable and Non-Discriminatory (FRAND) obligations for standard essential patents (SEPs). These twin decisions appear to bring trans-Atlantic decision making on issues of FRAND obligations in a standard setting environment closer together than has been the case for some time. The decisions also recognize recent legal and economic understandings that apply a more balanced approach to defining FRAND obligations such that, still within the context of assuring that implementers can profitably sell the final product, SEP holders receive sufficient reward to incentivize their risk taking and willingness to partake in societally beneficial standard-setting activities.

EI Principal Robert D. Stoner consults on issues at the intersection of antitrust and intellectual property.

In the first decision, the Ninth Circuit Panel reversed the District Court decision in *FTC v. Qualcomm, Inc.* The District Court decision favored the Federal Trade Commission's ("FTC") position that patent holder Qualcomm's conduct in refusing to license rival chipset makers (and insisting on a SEP license from handset makers as a condition for receiving chips) was anticompetitive. In the second decision, the UK Supreme Court affirmed the lower court decision in *Unwired Planet v. Huawei* that largely favored patent holders. This case involved the patent infringement claims of Unwired Planet, a patent assertion entity (PAE), against implementer Huawei under telecom standards developed by The Third Generation Partnership Project (3GPP), where ETSI, an international standard setting organization (SSO), serves as the secretariat. Unwired Planet had offered to license its SEPs on a worldwide basis, but Huawei objected to the royalty rate as not FRAND and to the inclusion of SEPs beyond UK SEPs. The UK Supreme Court held that an English court can enjoin infringement of UK SEPs where the infringer is willing to take a UK license but refuses a worldwide license that the court has determined to be FRAND.

> "Similarly, the UK Supreme Court *Unwired Planet* decision moves towards a more balanced approach to defining FRAND obligations."

The Ninth Circuit Panel's *Qualcomm* decision is notable for several reasons. First, it states that the potential violation of a FRAND commitment made by a SEP holder does not give rise to antitrust liability as long as it springs from the exercise of lawfully gained monopoly power where there was no overtly deceptive conduct that led to inclusion of its SEPs in the standard. It appears that the policy arguments of several intervenors, including an unprecedented amicus brief by the United States Department of Justice ("DOJ") stating that contract and patent remedies are more appropriate to handle FRAND disputes than the antitrust laws, influenced the panel. The panel reasoned that there was no harm to competition from the legitimate exercise of SEP monopoly power and to limit that exercise through the application of the antitrust laws could reduce risk-taking and innovation.

The Ninth Circuit panel also rejected the District Court's finding that Qualcomm's royalties were unreasonably high (or non-FRAND) because they were imposed at the handset level, as opposed to at the level of the smallest salable patent practicing unit (SSPPU), which arguably is the modem chip. The panel found that there was no competition law principle that requires that patent royalties be based on SSPPU and that such a rule would conflict with the "comparable license" approach to patent valuation, noting that sophisticated parties routinely enter into licensing agreements that set royalties as a percentage of the final product price. From an economic perspective, evidence from actual licenses seems preferable to constructing hypothetical negotiations based on a principle (SSPPU) that the licensor has not used.

Similarly, the UK Supreme Court *Unwired Planet* decision moves towards a more balanced approach to defining FRAND obligations. Earlier cases under European Union ("EU") competition law (e.g., *Huawei v. ZTE*) applied the antitrust laws to FRAND licensing disputes where there is a "willing" licensee, finding an "abuse of dominance" where a SEP holder seeks an injunction under these circumstances. More recent decisions in EU member states (e.g., the German Federal Court of Justice's decision in *Sisvel v. Haier*)

continued on page 4

A Review of *Controlling Mergers and Market Power: A Program for Reviving Antitrust in America*

Robert A. Arons

John Kwoka's new book *Controlling Mergers and Market Power: A Program for Reviving Antitrust in America* likely will serve as a guidepost for future antitrust regulation and enforcement. Dr. Kwoka discusses facts concerning merger review and includes several actionable recommendations. This article discusses three of Dr. Kwoka's recommendations: reviving the structural presumption, increasing the use of merger retrospective studies, and new enforcement criteria for the future of antitrust in the digital age. Whether one agrees or disagrees with these recommendations, the issues discussed by Dr. Kwoka are ones that antitrust policymakers will have to address in the near future.

Dr. Kwoka highlights several facts, and these facts inform his recommendations. Dr. Kwoka highlights that the number of Hart-Scott-Rodino ("HSR") reportable deals that received a second request by the Federal Trade Commission ("FTC") or Department of Justice ("DOJ") each year has remained steady, while the number of HSR-reportable mergers has doubled since 2010. This indicates that the percentage of deals receiving significant attention has declined over the past decade.

Additionally, Dr. Kwoka discusses the decline in the number of public firms, the national decline in new startups, the rise in corporate profits, and recent studies showing that markups in the United States have risen from twenty-one percent on average in the 1980s to over fifty percent after 2010. These facts suggest that markets have become drastically less competitive over the past forty years. Dr. Kwoka thus argues for a more aggressive antitrust policy. Specifically, he recommends blocking all mergers where the structural presumption is met (the Herfindahl-Hirschman index ("HHI") is at least 2,500 with the change in HHI at least 200) or the number of competitors falls below four.

However, it is important to note a few possible counterfactuals to Dr. Kwoka's assessment of competition in the United States. First, while the total number of public firms has decreased, in some cases, the geographic reach or variety of products of the remaining firms has increased and thus prevented a loss of competition. For example, Walmart might move into a town and displace a hardware store, drug store, and grocery store. This decreases the total number of firms in town by two. However, if customers did not view the hardware store, drug store, and grocery store as substitutes for purchasing products and if customers can still purchase these products at Walmart, the level of competition remains constant. Second, while increased markups may result from decreased competition, increased markups also can stem from increased product variety. If new products are more specialized, they may appeal to a narrower set of consumers who have a higher willingness to pay for these "niche" products. This can lead to higher markups. A recent study of product selection in retail stores from 2006 to 2017 finds that the "nicheness" of offered products has increased, leading to consumer demand becoming less elastic (Brand, James, "Differences in Differentiation: Rising Variety and Markups in Retail Food Stores"). A similar study, focused on the automobile industry, found that while HHIs decreased in the past twenty years, markups and product quality increased (Greico, Paul *et al*, "The Evolution of Market Power in the U.S. Auto Industry"). These examples suggest that the facts highlighted by Dr. Kwoka may not be sufficient to draw a conclusion that markets today are less competitive or that all mergers exceeding the structural presumption are anticompetitive. Dr. Kwoka's recommendation also would be a departure from the *Horizontal Merger Guidelines*, which state that the HHI thresholds are not intended to be a rigid screen.

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In making his second recommendation, Dr. Kwoka states that a lack of information among antitrust practitioners, policy makers, and judges is an "impediment to sound policy process." In particular, the agencies have conducted very few retrospectives to determine if their decisions were the right ones to preserve competition. The importance of retrospectives is clear. Better knowledge of the success of past practices can inform how to evaluate current antitrust problems. Dr. Kwoka recommends that the DOJ and

EI Senior Economist Robert A. Arons has worked on matters involving market definition, structural presumption, and competitive effects. Prior to joining EI, Dr. Arons was an economist in the DOJ Antitrust Division.

continued on page 4

Qualcomm and Unwired Planet

took steps to limit the impact of these earlier decisions, making it more difficult for a licensee to argue it was "willing" if it failed to enter into good faith negotiations or engaged in other opportunistic conduct. The *Unwired Planet* decision is the most decisive step away from the earlier EU cases and appears to move the EU position much closer to the position of the *Qualcomm* panel.

In particular, the UK Supreme Court relied on ETSI's written patent policy that expresses the need for "balance" between implementers and SEP holders to support its finding that SEP holders may seek an injunction against implementers who do not enter potentially FRAND licensing agreements. The Court found that Unwired Planet had shown itself to be a willing licensor by its offer of a global license to Huawei and that an injunction could be warranted if it was necessary to prevent continued infringement. Otherwise, it would be "difficult for the SEP owner to enforce its rights," forcing the owner "to accept a lower royalty rate than is fair" and denying "the fruit of its research and innovation."

The UK Supreme Court also opined regarding the non-discrimination prong of FRAND, finding that it was not a separate element from the obligation to license on fair and reasonable terms. Moreover, non-discrimination did not mean that patent terms could not differ due to normal commercial justifications, as long as there was a single royalty price list available to all. Nor were licensors obliged to give "most-favorable-licensee" treatment to every licensee, which could discourage price competition. Effectively, the FRAND obligation was judged not to prohibit Unwired Planet from giving better effective rates to another licensee than to Huawei, as long as both terms could be deemed FRAND.

Both the *Qualcomm* and *Unwired Planet* judgments clarify some, though not all, important legal and economic questions relating to the balance between SEP holder and implementer rights implied by FRAND commitments. However, these decisions, which in each case were the culmination of litigations that had lasted for years, also revealed how fractured and hotly debated these issues still are, as the terrain now appears to tilt to a more patent-holder-friendly regime on both sides of the Atlantic.

A Review of Controlling Mergers and Market Power

FTC carry out *ex post* investigations. He suggests individual case-studies as well as broader regression analyses comparing prices before and after mergers, while controlling for changing supply and demand factors. This recommended approach may be cost effective, since these agencies already have knowledge and experience in the industries and in carrying out the appropriate regression analyses.

Dr. Kwoka's third recommendation focuses on the tech sector and nascent competition. He finds that there is a primary weakness with antitrust policy in the tech sector. Specifically, while two merging firms may have products that are close in the product space but which currently are not substitutes, all it takes is a few lines of code to turn them into fierce competitors. These types of proposed mergers raise thorny issues when analyzing the relevant market. Dr. Kwoka recommends that acquisitions of potential competitors by dominant tech companies should be *per se* illegal. However, this recommendation may be ahead of what economics can say about this type of competition. For example, if it is true that tech products can be retooled to compete in different product spaces, then that implies barriers to entry are low. Therefore, in some cases merger activity is unlikely to harm competition, because the competitive influence of one nascent competitor can readily be replaced by another nascent competitor. This is the type of question the FTC likely will have to address as part of its Facebook lawsuit -- why WhatsApp and Instagram were close nascent competitors to Facebook while TikTok, a social media app for video sharing with over a billion daily active users, is not.

In sum, Dr. Kwoka's new book identifies key unresolved issues inherent to antitrust policy in the United States. Dr. Kwoka also highlights several facts and makes policy recommendations based on these facts. However, a full consideration of the economic literature suggests that there are counterfactual examples that may lead to different competitive outcomes than those highlighted by Dr. Kwoka and which inform his policy recommendations.

EI News and Notes

Keith Waehrer and Cagatay Koc Join EI

Keith Waehrer and Cagatay Koc recently joined EI's Washington DC office. Dr. Waehrer has extensive antitrust experience, including testimony at deposition and trial on mergers, monopolization claims, and calculations of reasonable royalties. Dr. Waehrer has worked on numerous antitrust cases in the United States and European Union and was an economist in the Antitrust Division of the Department of Justice. Dr. Koc has over fifteen years of consulting experience and has provided expert testimony in cases involving collusion, alleged overcharges, damages, and M&A-related energy valuations. Dr. Koc also has been a visiting scholar at the Federal Trade Commission (Bureau of Economics).

Washington State District Court Denies Certification for Policy Holder Class

A U.S. District Court for the Western District of Washington denied certification to a putative class of automobile insurance policyholders whose vehicles were stolen or totaled in accidents. Plaintiffs alleged that the insurance companies failed to itemize the condition adjustments properly. The Court ruled that proof of liability would require demonstration that the adjustments were inappropriate in dollar amount and that that determination would be individualized. EI President Jonathan Walker testified in support of the insurance companies' opposition to class certification.

FERC Approves NRG Acquisition of Direct Energy

The Federal Energy Regulatory Commission recently approved NRG Energy's acquisition of Direct Energy from Centrica PLC. As part of its application under Section 203 of the Federal Power Act, NRG submitted a market power study authored by EI Principal John R. Morris. NRG was represented by McDermott Will & Emery LLP.

Auction Group Presents at the 9th Annual Americas Spectrum Management Conference

During the 9th Annual Americas Spectrum Management Conference, EI Economist Christopher T. Sojourner gave a demonstration on bidding basics in a high-stakes, FCC-style auction followed by a panel discussion including EI Principal Allan T. Ingraham, EI Economist Shreyas Ravi, and EI Analysts Gabriel Perez and Katherine Senseman.

Su Sun Publishes Article on China's Antitrust Fines

Senior Vice President Su Sun's coauthored article "The Draft Fining Guidelines and the Future of Antitrust Fines in China" is published in the *Journal of Antitrust Enforcement*. Dr. Sun and coauthor, Professor Chenying Zhang of Tsinghua University Law School, predict that antitrust fines in China will be higher after China's antitrust fining guidelines are implemented.

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