THE ECONOMIC CASE AGAINST LICENSING NEGOTIATION GROUPS IN THE INTERNET OF THINGS

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Executive Summary

Competition policy generally prohibits coordination among buyers or sellers, especially coordination on price, price-related inputs, and output that directly endangers the free play of competitive forces. Nonetheless it has been periodically proposed that this rule should be relaxed to permit the formation of licensing negotiation groups ("LNGs") in markets for standard-essential patents (or "SEPs") relating to wireless communications technologies. This proposal has no sound basis in economic theory or evidence. Contrary to common assertions, there is no evidence showing that SEP licensing markets widely suffer from "patent hold-up" or "royalty stacking." To the contrary: over three decades of market performance indicate that aggregate SEP royalty rates have consistently reflected single-digit percentages of device prices, which is consistent with the rapid rates of adoption enjoyed by wireless communications technologies during this period. Given the robust performance of wireless markets, the proposed relaxation of the rule against horizontal cooperation is likely to degrade, rather than enhance, competitive conditions as 5G technology is deployed in the "Internet of Things". In the short term, LNGs would simply redistribute economic value from innovators (net licensors) to implementers (net licensees) in the technology supply chain without necessarily passing on cost-savings to consumers. In the medium to longer term, LNGs would pose a risk to the standard-development and licensing-based monetization strategies that have supported the wireless communications industry's iterative model of technology development. Through these patent-dependent structures, wireless markets have funded continuous R&D investment, promoted dissemination of technology inputs, maintained interoperability, facilitated entry in device production, and enabled transformative business models across a wide range of industries. Initial deployment of 5G technology in the wireless communications and automotive industries has largely followed this transactional framework with little indication of material impediments to adoption by implementers. While LNGs may reduce the transaction costs of SEP licensing, the information technology industry has a long record of establishing independently administered patent pooling structures that achieve the same objective at a substantially lower risk of competitive harm.

"Bullet Point" Highlights

1. Empirical studies find little evidence that wireless technology markets widely suffer from "patent holdup" or "royalty stacking." Rather, these studies find modest aggregate royalty rates that are consistent with the exceptionally rapid and broad adoption of wireless-enabled technologies around the world.

2. Licensing negotiation groups are a form of buyer coordination that inherently poses a risk to the free play of competitive forces in determining prices for technology inputs and the devices that rely on those inputs.

3. The exceptional success of modern wireless markets has relied on a unique framework of standard-development and licensing-based monetization strategies to develop, integrate, and commercialize technological innovations. Without a secure foundation in the patent system, the viability of these structures stands in doubt.

4. Information technology markets have a demonstrated history of using independently administered patent pools to achieve transaction-cost savings and, compared to licensing negotiation groups, can do so at a lower risk of competitive harm.