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Innovation and competition

*Check Against Delivery
Seul le texte prononcé fait foi
Es gilt das gesprochene Wort*

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1. Introduction: anti-competitive and pro-competitive agreements and innovation

Ladies and Gentlemen,

It is a pleasure to be at Fordham again and to take part in this morning's panel on the relationship between competition and innovation.

I am delighted that **Ronan Harty**, **Michael Reynolds** and **Philippe Rinczaux** are joining me for this session. Before hearing their expert views, I'd like to start by referring to **four themes** that we can then further explore together.

I would like to talk about the relationship between **agreements between competitors and innovation**; then more generally about how **competition policy can promote innovation**; about the **links between competition law** and **intellectual property law**; and I will finish by looking in a little more detail at **innovation in high-tech markets**.

Let me first state the obvious: competition drives innovation. Why? First, because it forces companies to cut their costs, and that requires innovation. Second, it prompts them to produce better products and services than their competitors and this also calls for innovation.

A first area I will refer to concerns the relationship between agreements between competitors and innovation.

Strange though this may sound, let me start this discussion with a reference to **cartels**.

Cartels undermine innovation and this point is not made frequently enough. In the comfort zone of their illegal agreements, cartelists have lower or no incentives to invest in innovation.

Economic studies confirm this, showing that cartelised industries behave irrationally in commercial terms when it comes to research, development and innovation.

In many instances, the consequence of entering a cartel is actually a drop in productivity and innovation, as confirmed by an OECD report for instance.¹ Collusive behaviour can also lead to situations where insufficient resources are dedicated to R&D and the lifetime of outdated products is artificially extended.

Naturally, the effects on innovation will always depend on the sector, the aim of the cartel and its geographic reach. The most negative impact is observed in strongly concentrated markets; in markets where entry or development costs are particularly high; or in declining markets where the product has reached the end of its lifecycle.

¹ For example, the OECD "*Report on the nature and impact of hard core cartels and sanctions against cartels under national competition law*" of 2002 concludes that "*a cartel shelters its members from full exposure to market forces, reducing pressures on them to control costs and to innovate*".

In cartelised markets, the innovation stemming from the competitors of a cartel can also be slowed down: efficient newcomers are prevented from entering; there may be refusals of access to technology, misuse of patent pools and so on. Such practices may reduce innovation overall, especially in high-tech markets. One can wonder for instance about the long-term impact on innovation of the cartels that the Commission has recently dealt with in cases such as *LCD* or the on-going case concerning *optical disk drives*. It is easy to imagine in such markets that if the cartel ensures sufficient margins and / or stabilises market shares, then companies have fewer incentives to innovate and move to newer technologies.

There is a serious risk that the retrogressive effects of cartels on the development of new technologies will ultimately harm the entire industry.

Now this is the bad news. But, in contrast to cartels, there are many instances where **lawful cooperation between competitors** can favour innovation; and this is my second point.

Take for example **research and development agreements**. An R&D&I agreement may bring together different research capabilities that allow firms to produce better and cheaper products and shorten the time for those products to reach the market. Depending on their characteristics, it is frequent that such agreements bring together complementary skills and may trigger further innovation.

The **transfer of technology** is another cooperative aspect that is very important for businesses. An OECD study of 2009² showed that around 20% of European companies holding industrial intellectual property rights are licensing to other non-affiliated companies. From a social-welfare perspective, licensing has many potentially positive effects such as increasing the diffusion of technology, reducing barriers to entry and incentivising future innovation.

How does this work? For example, two competitors could cross-license their current complementary technologies so as to be able to enter new markets. This is in particular beneficial if, without the cross-license agreement, both competitors would not be able to produce new products.

However, like R&D agreements, licensing agreements or certain clauses within these agreements can also facilitate collusion, foreclose competitors or harm inter- or intra-technology competition by reducing the incentives to innovate. This is where enforcers come in and this is also why we need legal certainty.

Our current rules on the assessment **of licensing agreements for the transfer of technology** are being reviewed as they will expire in 2014.

² Pluvia Zuniga, M. and D. Guellec (2009), "Who Licenses out Patents and Why?: Lessons from a Business Survey", *OECD Science, Technology and Industry Working Papers*, 2009/5, OECD publishing, © OECD.

In this review our objective is to strengthen the incentives for innovation while preserving effective competition. A public consultation on a draft amended technology transfer block exemption and guidelines will be launched in 2013, with the final texts scheduled for adoption in early 2014.

2. Competition policy as driver of innovation: sector examples

I would now like to turn to a few concrete **examples** that illustrate how enforcing competition rules and embedding competition principles in policy-making can support innovation.

Liberalisation – the opening up of markets to competition – is perhaps the most obvious first example.

Innovation in, for example, the telecoms and transport sectors in Europe was clearly driven by the liberalisation process.

In **air transport**, low-cost carriers came in to undercut the incumbents once the sector was opened to competition and the incumbents were forced to respond. Airlines now deploy newer and more fuel-efficient aircraft and they have decreased aircraft turnaround times. The low-cost airlines' model has spurred ancillary innovation, such as the increased use of Internet in air travel and the construction of dedicated low-cost terminals. Liberalisation has overall contributed to diversifying the airline business models.

EU competition policy contributed to protecting the benefits of this liberalisation. We stepped in to facilitate competitors' entry, which is essential for continuous innovation. For example, in the *Oneworld joint-venture* case the commitments accepted by the Commission resulted in a new competitor, Delta Air Lines, entering the London-Boston route.

We have also received several applications for slots at London Heathrow for flights to domestic and European destinations under the commitments in the *IAG/bmi merger case*.

In the **telecom sector**, the liberalisation of former monopolies was a major success. Through a series of regulatory measures and antitrust enforcement, access to the networks of the incumbent operators was made possible and allowed new companies to enter markets throughout Europe. Increased competition led to the more rapid development of innovative technologies such as ever faster – and cheaper – broadband connections.

Another sector I wanted to mention is the **payments sector**. As Vice President Almunia has stated several times, there is still a lot of work to do to bring Europe's payments markets in line with the times and the expectations of businesses and consumers.

Innovative payment techniques do exist - such as the possibility to use smartphone electronic wallets - but it appears generally difficult for them to enter the market, even if consumers would welcome it.

This may be due to the natural reluctance of the banks to lose their current income from interchange fees with card payments.

In a similar way to the processes that have taken place in the ICT sector, the payments industry should explore not only new technology, but also new business models. And when they do, it will be the job of competition authorities and regulators to make sure that consumers and industry actually benefit from these.

In particular, we must be careful that safety and other standards – however important they are in this industry - are not used as a pretext to hinder competition and block innovation.

For example, we see that telecom operators want to enter the payments market and that internet payment providers are ready to move to payment in shops and this can only be welcomed from a competition standpoint.

After an in-depth inquiry under our merger rules, we have given an unconditional green light to a joint venture created by the UK telecom operators Vodafone UK, Telefónica UK and Everything Everywhere in the field of mobile commerce in the UK to provide so-called mobile wallets. Their co-operation did not raise competition concerns since alternatives are very likely to emerge in the near future. The Commission is keen on promoting innovation in this area and ensuring that the markets remain open so that a number of competing solutions can emerge without undue obstacles, to the benefit of consumers.

In spite of these new developments, we believe that there is still a risk that innovation in payments markets is hampered by hidden interchange fees.

In its recent judgement in the *MasterCard* case, the EU General Court fully confirmed our assessment on the restrictive effect of collectively agreed interbank fees and that Mastercard had not justified its multilateral interchange fees in terms of benefits for merchants and consumers. It is important that all parties in the payments market adapt their behaviour in light of this judgment. At the same time a reflection is on-going on whether the issues in the payments market would require more comprehensive solutions, going beyond ad hoc competition law intervention, such as single market legislation. In this respect we are of course keen to draw from lessons learned with legislation in the United States.

It is very important for us in the EU that legislation and competition enforcement are applied hand in hand. Open, secure and innovative payments markets are crucial for our economy and for the smooth functioning of our Single Market.

3. Relationship between competition law and intellectual property rights ("IPRs").

Intellectual property rights are broadly seen as a mechanism that drives innovation. Nonetheless, IPRs and competition law frequently appear to be at odds. This is because intellectual property law confers exclusive rights upon its owners, whereas competition law seeks to keep markets as open as possible.

However, such a tension is too simplistic. In reality, both types of law share the objectives of promoting consumer welfare and an efficient allocation of resources. Generally speaking, if intellectual property rights are properly defined or delimited, the scope for anti-competitive conduct becomes narrower. Let me refer to some examples to illustrate this point:

3.1 Standardisation and standard essential patents

An area of particular complexity is **standardisation**. There are many competition issues around standardisation processes, with possible allegations of exploitative abuses of market power.

When the Commission revised its Guidelines on **Horizontal Agreements** in 2010, we spent some time looking at best practices for standardisation procedures to give them a safe harbour under the competition rules.

We concluded that **proper rules on disclosure of IP** and **FRAND commitments** are crucial. FRAND commitments are designed to ensure that essential IPR protected technology incorporated in a standard is accessible to the users of that standard on fair, reasonable and non-discriminatory terms and conditions.

Standards which are agreed and freely entered into are tremendously beneficial to a range of markets. For instance they create economies of scale and scope and reduce barriers to entry by fostering interoperability.

At the same time, ownership of intellectual property rights essential to standards can confer market power.

This is why commitments to license these rights in the context of standardisation agreements are extremely important in preventing IPR holders from making the implementation of a standard difficult. This could happen by refusing to license or by requesting excessive fees after the industry has been locked in to the standard, or by charging discriminatory royalties.

Once a FRAND commitment has been given, it must be adhered to. We are currently looking at several cases where, by threatening to use injunctions, holders of **standard-essential patents** put themselves in a position to make demands that their commercial partners would not accept outside of a standard, thus in breach of FRAND.

We have also investigate the *Google/Motorola* merger where a consideration was whether, post-merger, the threat of injunctions could be used by Google to extract patent cross-licences from competitors on terms they would otherwise not have agreed to. We came to the conclusion that the market situation was not significantly changed by the transaction so the merger was cleared.

This was not an isolated case. We are currently investigating the alleged strategic use of standard-essential patents in the mobile telephony sector: we opened proceedings against Samsung and Motorola Mobility (now fully owned by Google). In these cases the European Commission is investigating whether Samsung and Motorola have abusively used certain of their standard essential patent rights to distort competition in the Internal Market, in contravention of commitments they gave to standard setting organisations to licence those standard-essential patents on FRAND terms.

3.2 Exhaustion of IP rights; patent expiry

It is also worth mentioning at this stage issues linked to the **exhaustion of IP rights** or **patent expiry**.

Over the years, the EU Courts have extensively used the exhaustion doctrine (whereby the purchaser of a patented product is free to use or sell this product without any restraint from the original patent) to strengthen the Single Market. The owners of a national patent or trade mark were not allowed to rely on this right to prevent parallel imports from other Member States, as this would not have been compatible with the ban on quantitative restrictions on imports and measures having equal effect.

The Court of Justice held in a series of cases that, once the goods were put on the market with the IP owner's consent within the EU, his distribution rights were exhausted. Through a similar reasoning, the ECJ has this July ruled in the ***UsedSoft v Oracle*** case concerning the **second hand sales of software**.

It held that the principle of exhaustion of the distribution right applies not only where the copyright holder markets copies of his software on a material medium (CD-ROM or DVD), but also where he distributes them by means of downloads from his website.

In essence, where the copyright holder makes available to his customer a copy and concludes in return a licence agreement granting the customer the right to use that copy for an unlimited period, the right holder exhausts his exclusive distribution right.

The Court held that such a transaction involves a transfer of the right of ownership of the copy. Therefore, even if the licence agreement prohibits a further transfer, the right holder can no longer oppose the resale of that copy.

Issues related to patent expiry also often arise in the **pharmaceutical field** as discussed yesterday by Jon Leibowitz. As highlighted by the Commission's Report following our

pharmaceutical sector inquiry, competition problems arise in particular when the patents protecting the most popular medicines approach expiry.

It is in these situations that we see **settlements** where generic companies agree to cease patent litigation and accept a restriction of market entry against the transfer of an advantage – a practice that is known as "**pay for delay deals**".

We have continued to monitor patent settlements and you may have heard that the Commission has just issued statements of objections in two cases involving patent settlements, *Servier* and *Lundbeck*. Without prejudging these cases, we are concerned that these companies may have unduly protected their market exclusivity for certain medicines by agreeing with their generic competitors in exchange for payments, that their cheaper generic products would not enter the market.

I'd now like to move to the final theme of my introduction: high-tech markets.

4. Innovation in high-tech markets

4.1 Maintaining incentives to invest in innovation

Over the years, the Commission has supported **interoperable solutions** in the IT sector. Without predicting which business models and products would prevail, we deem that open and interoperable models favour market entry by a greater number of players and that they stimulate competition. We also believe that such systems attract innovation, by bringing its costs down.

When intervening in high-tech markets, it is important of course to strike a careful balance so as not to undermine undertakings' **incentives to invest and innovate**.

The starting position is that any undertaking, whether dominant or not, should have the right to choose its trading partners and to dispose of its property freely.

An **obligation to supply** — even against fair remuneration — may undermine undertakings' incentives to invest and innovate. There is also the real risk of free riding by competitors on investments made by the dominant undertaking. Neither of these consequences would, in the long run, be in the interest of consumers.

At the same time, there is always a balance to be drawn. An obligation to supply may be justified in exceptional circumstances, as the Microsoft interoperability case showed. We may also have to look at the terms and conditions of supply. That a company may have previously given a FRAND commitment in the context of a standardisation process may also be relevant.

Sometimes, intervention may prove necessary.

Our vigilance in high-tech markets will continue to be high. In digital industries, network effects and lock-in can create entrenched market positions which can be used to exclude competitors or new entrants. And this is why we are particularly wary of dominance. Secondly, this is also an issue of speed.

As stated by the ECJ in its Telia Sonera ruling of last year, " the [...] *application of [competition rules] cannot depend on whether the market concerned has already reached a certain level of maturity. Particularly in a **rapidly growing market, Article 102 TFEU requires action as quickly as possible**, to prevent the formation and consolidation in that market of a competitive structure distorted by the abusive strategy of an undertaking [...]*".

Such rulings thus highlight the **need for quick enforcement** in fast-moving markets and confirm that antitrust intervention does not have chilling effects on innovation.

This brings me to my final point: the need for adequate remedies.

4.2 Finding the right remedies

As law enforcers, we share on both sides of the Atlantic a desire to find well-tailored remedies that respond to our concerns and that arrive before the next innovation is already around the corner.

Our EU experience has shown that **commitment decisions** can be a very effective way to achieve this in antitrust cases. This is one of the reasons behind our current technical discussions with **Google**. We have voiced our openness to explore the commitments route and the discussions are ongoing.

Of course, commitment decisions are only effective if the companies strictly adhere to their undertakings. This is why we are analysing as a matter of priority the alleged breach by **Microsoft** of its 2009 commitments concerning the browser choice screen. As a consequence of this unfortunate situation, we are considering a strengthening of our monitoring mechanisms in all commitment cases.

Conclusion

Ladies and gentlemen, what we do as competition enforcers has to be put in the broader context. As always there are two sides to the coin.

On the one side, the vigilance of competition enforcers is particularly important in these times of economic downturn. Anti-competitive behaviour imposes a hidden cost on consumers and on the companies that play by the rules. Our economies cannot afford it.

On the other side, what I have also attempted to demonstrate today, markets are most conducive to innovation when they are open and accessible to all.

It is no luxury to remind ourselves and the ones who sometimes forget it: competition is a driver of innovation and competitiveness, and therefore the key to well-functioning markets where businesses can grow.

At a time when we need to grow out of the crisis, competition is thus more needed than ever.