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# Issues in Competition Economics of IP Rights

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# Overview

- **The IP trade-off**
- **Competition concerns when incorporating patents in standards**
- **Parallel trade in pharmaceuticals**

## The IP trade-off

- **IP rights promote innovation**
  - IP rights provide innovators with a temporary right to exclude infringers
  - This right to exclude can help innovators realise the profits needed to induce investment in innovation
- **From a consumer welfare perspective IP rights involve a trade-off**
  - Granting IP rights results in less competition, conditional on the innovation coming into existence
  - System of IP rights reflects judgment that long-run benefits of increased innovation exceeds costs of short-run reduction in competition

## Competition concerns when incorporating patents in standards (1/2)

- **Standards can produce substantial benefits**
  - Standard-setting processes can achieve coordination on the best possible technology
  - Agreeing on an industry standard, may avoid costs and delays of a standards war, thus reducing transaction costs to consumers and firms
- **Antitrust liability of standards may involve hold-up problem**
  - After SSO has chosen a technology as the standard and users have incurred sunk costs increasing the costs of switching to another standard, the owner of the patented technology may have market power to extract royalties that reflect absence of competitive constraints
- **SSO's try to mitigate the hold-up problem**
  - Patent owners commit to license IP that is essential to a standard on Fair Reasonable and Non-Discriminatory (“FRAND”) terms

## Competition concerns when incorporating patents in standards (2/2)

- **Which licensing practices of a holder of IP rights in a standard harm competition?**
  - *Rambus*
  - *Qualcomm*
- **Natural benchmark for FRAND royalties is royalty rate that would have been negotiated before standard was adopted**
  - Auction in which owners of different technologies compete to be included in standard by submitting royalty rate bids
  - How to implement such a benchmark?
- **Courts are familiar with comparable-transaction analysis for maximum royalty and “share of essential patents” approach**

## Parallel trade in pharmaceuticals (1/2)

- **Pharmaceutical companies need to recover the common fixed costs of R&D**
- **Price differentials between countries reflect the attempts by governments to reward and encourage investments in R&D**
- **A dual pricing scheme is a scheme where the manufacturer charges a low price to the wholesaler only if the product is sold to pharmacies in the low price country, and a high price otherwise**
  - *GlaxoSmithKline DP*
- **European Commission has asserted the need for encouragement of parallel trade to be the overriding consideration**

## Parallel trade in pharmaceuticals (2/2)

- **Parallel imports influence consumer welfare in three ways**
  - Consumers in importing countries benefit through lower prices
  - All consumers may experience a decline in supply of new drugs due to reduced incentives of manufacturers to invest in R&D
    - Suppose parallel imports cause sales and profits to fall by €50m
    - €7.5m less R&D spending since pharmaceutical R&D typically equals 15% of sales
    - As €1.000 in R&D produces one additional life-year, parallel imports potentially come at the expense of 7.500 life-years
    - Empirical literature suggests a life-year is worth €75.000, implying that costs of parallel imports to consumers are over €500m
  - Consumers in exporting countries may experience delays in launch of new drugs and parallel trade causes instabilities in supply chain

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