

There's no Free Lunch with IPR: Why Capping Aggregate IPR Charges is Bad for Innovation, Competition and Consumers

Nobody's suggesting handset or network equipment prices, wireless service fees or operating profits should be capped, so why pick on patented Intellectual Property Rights (IPR)?

Different types of companies in the mobile technology business seek to use their patents differently to compete and make a return on their R&D investments. The two most prevalent models are with firms that widely license their IPR for revenue and with other firms that seek to maximize profits from sales of products by minimizing IPR costs while also excluding competitors.

The announcement by several vendors seeking to cap aggregate royalties for "essential" LTE patents at 10% is not altruism. It's a scheme to preserve and extend a business model that has marginalized or excluded many small and innovative manufacturers in licensing negotiations and has concentrated handset device and cell site equipment market share in GSM. It would also slice margins for companies that choose to make most of their living out of selling IPR rather than complete products and dramatically reduce their ability to reinvest in ways that can foster competition and increase consumer choice. It would discount the price of IPR without any guarantees that such discounts will be actually passed on to consumers.

While mobile technology device and infrastructure vendors with large market shares make profits using other companies' patented inventions, they would like to minimize or avoid paying IPR royalties. Simple arithmetic demonstrates that royalty payments by Nokia on its 39% market share of handset sales should dwarf what it can earn on licensing its IPR to other vendors. Despite the fact that some of these large companies may have significant ownership of applicable IP, their substantial product businesses make it very difficult for them to charge royalties to smaller competitors who also own relevant IP. By counting patents to determine value on a "proportional" basis, these large companies will also try to increase their royalties or exclude smaller competitors that have fewer patents, even if these are very significant.

This proposed arrangement will create an oligopoly among a small number of large IP owners who simply take the cost reduction in retained profits on product sales. This is the prevailing IP business model in GSM with the top five vendors commanding 88% market share in 2007. For example, whereas Nokia is not currently paying royalties on its UMTS handsets to either Qualcomm or InterDigital Communications, most of its competitors are. Nokia's UMTS prices are generally higher than average and its handset operating profit margins are stellar at more than 20%.

If adopted, this new IPR structure would make it even more difficult for smaller competitors to enter the market and successfully challenge the entrenched suppliers. Meanwhile, royalty caps can freeze-out innovators such as Qualcomm, InterDigital and others who rely more heavily on IP royalties rather than complete product sales to fund their R&D. The business model in CDMA2000—with all licensees paying rather similar rates, without aggregate royalty caps and with aggregate royalties significantly below 10%—has created a far less concentrated supply market. The top five vendors have only 64% market share. The increased competition provides more customer choice and drives down end-user prices.

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