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"Innovation and the Regulation of Dominant Firms"

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Innovation is an unpredictable beast. For almost forty years, starting in 1885, Alexander Graham Bell used 3414 Volta Place, just a short distance from here, as his laboratory. Back in 1885, no-one could have guessed how his work would transform the world, or that in 1949 the Department of Justice would have to bring a monopoly case against Bell.

As the physicist Niels Bohr once said: 'prediction is difficult, especially about the future'. What competition authorities can do is provide a solid legal framework for innovation. Our role is not to protect competitors, or to hamper successful firms. Our role is to protect the competitive process. When we succeed we keep the doors and windows open for innovation and we help markets work better.

Having the right framework for action also frees us from old ghosts. It makes it clear that good competition policy is not about keeping failing competitors alive. Nor is it about punishing successful firms. Competition policy should be about building a market that is genuinely free because it is fair, because it rewards present innovation without stifling future innovation.

There were, once, good reasons for believing that competition and innovation were fundamentally antagonistic. Schumpeter argued that the excess profits of monopoly free up resources for long-term investments. His case still makes intuitive sense: competition, including price competition, ensures static efficiency; but without profits, firms cannot pay for innovation. If this were true, it would leave antitrust authorities in a quandary. If competition stifles innovation, then we could have either dynamic or static efficiency, but not both.

However, case studies across the developed world have consistently proven Schumpeter wrong. Monopolists seem to value a quiet life, which J.R. Hicks called 'the best of all monopoly profits', over the potential gains from innovation.

What is true is that creating intellectual property can be a high-investment and high-risk business. The system only works if the individuals and businesses brave enough to take these risks get the proper reward.

This is why (in 2004) we introduced new rules for applying competition policy to the licensing of patents, know-how and software copyright - the Technology Transfer Block Exemption Regulation and accompanying Guidelines. We also appreciate that licensing an individual piece of technology is often not useful – so our technology transfer Guidelines have a thorough section on the assessment of patent pools.

This is also why we are delighted when Microsoft, or any other company, profits from innovation. We did object, however, to Microsoft charging fees that were divorced from the intrinsic value of its interoperability information and not linked to reasonable and non-discriminatory license conditions and rates.

Intervening on a properly proven case is vital. Conversely, we should also have the courage to stay out when our intervention is not necessary.

Take the Google/Doubleclick case.

On the face of it, there was a risk that this proposed merger could damage competition. Google has roughly 70% of online advertising related to search. Double click has roughly half of the worldwide ad serving market.

Their competitors argued that the merged company would dominate the internet advertising market. We ran a comprehensive economic analysis, which benefited greatly from the input of the FTC and we concluded that pre-merger Google and Doubleclick did not exert meaningful competitive pressure on each other and that post-merger they would not have enough market power to crowd out competitors including Microsoft, Yahoo, AOL and WPP. This led us to clear the merger without objection.

We also need to remember the fundamental lesson of innovation – things do not stay the same. Solutions that can seem flawless in 2008 may prove unworkable in 2018.

We have got into the habit of thinking of standards as something incrementally, informally set by the market. This is because Windows is a de facto, not a de jure standard. No regulation imposes the use of Windows, but software that does not mesh with it is practically worthless.

It is hard to ignore the importance of these de facto standards. At the same time, de jure standards pose their own set of challenges.

For example, the Commission is currently investigating allegations of a 'patent ambush' by Rambus. This is still in the early stages, but our preliminary view is that Rambus is abusing its dominant position by claiming unreasonable royalties for the use of its patents; royalties that Rambus would not have been able to charge without this patent ambush.

Meanwhile, we are also investigating whether Qualcomm has respected the fair, reasonable and non-discriminatory (FRAND) commitment it gave to relevant standard setting organisations before WCDMA was adopted as the 3G standard for mobile phones in Europe was respected.

I am conscious that my talk so far has been heavily weighted towards the IT industry. Let me correct that by finishing with a last example drawn from the pharmaceutical business.

In 2005 the Commission fined Astra Zeneca € 60 million. We did this because we found that Astra Zeneca had abused its dominant position by blocking market entry for generic competitors to its ulcer drug Losec. We of course recognize that revenue from patents is vital in this sector as in many others – but we also recognize that patents must have an end of life if we are to encourage the next generation of R&D and the next generation of patented drugs.

Losec was the best-selling drug for much of the 1990s, and as AstraZeneca's patent for its active ingredient ran out, they chose artificially to extend it by misleading national patent offices and by selectively deregistering some of the market authorisations for Losec. They could do this because at the time, generic products could only be marketed if the original product still had market authorization.

More widely, this shows how important it is that we understand markets as well as possible. Our sector inquiries into the retail banking sectors have already allowed us to move beyond theoretical discussion and look instead at the facts of how these complex markets work.

Our inquiry into the pharmaceutical sector is, if anything, even more important. A strong and competitive pharmaceutical industry is crucial to our finances, to our comfort and to our very lives.

This is why it is particularly worrying that there are signs that both innovation and competition is faltering in this sector. If innovative products are not being produced, and cheaper generic alternatives to existing products are being delayed, then we need to find out why and, if necessary, take action.

We intend to present preliminary findings in November this year and final results in the spring of 2009. If there are any innovative conclusions to be drawn, I hope that you will see them as the right ones.